

**Meeting:** International Public Sector Accounting  
Standards Board

**Meeting Location:** Ottawa, Canada

**Meeting Date:** December 2-5, 2013

## Agenda Item 6C

For:

☐ Approval

☒ Discussion

☐ Information

### Conceptual Framework: *Measurement of Assets and Liabilities in Financial Statements*

#### Objective(s) of Agenda Item

1. The objectives of the session are:
  - (a) To **consider** and **provide** directions on key issues identified by Staff; and
  - (b) To **review** a first draft of the final chapter on Measurement and **provide** directions for further development; and

#### Material(s) Presented

Agenda Item 6C.1	Issues Paper
Agenda Item 6C.2a	First Draft of Final Chapter, <i>Measurement (Mark-up)</i>
Agenda Item 6C.2b	First Draft of Final Chapter, <i>Measurement (Clean)</i>
Agenda Item 6C.3	Draft Minutes from September Meeting

## **CONCEPTUAL FRAMEWORK: ISSUES PAPER ON DRAFT FINAL CHAPTER ON MEASUREMENT**

### **Objectives of Issues Paper**

1. This Issues Paper highlights a number of issues related to the draft final chapter of the Conceptual Framework on Measurement for discussion and directions so that a further draft of the Measurement chapter can be brought to the March 2014 meeting.

### **Background**

2. Conceptual Framework Exposure Draft, *Measurement of Assets and Liabilities in Financial Statements* (CF–ED3), was issued in early November 2012 with a consultation period that expired on April 30, 2013. There were 39 responses to CF–ED3. At the September meeting the IPSASB considered a number of issues raised by staff and the Task Based Group (TBG). Notably, the IPSASB agreed on a measurement objective that links measurement to the objectives of financial reporting and gave staff directions on a number of other issues. The draft minutes of the September meeting are at Agenda Item 6C.3
3. The first draft of the final chapter is at Agenda Items 6C.2(a) and 6C.2(b). Agenda Item 6C.2(a) is a mark-up of CF–ED3 and Agenda Item 6C.2(b) is a clean version. The marked-up version contains a number of comment boxes in which staff explain the rationale for revisions and highlight certain issues. Staff thanks the TBG for their views on an earlier version of the draft final chapter.

### **Approach in Agenda Session**

4. Staff proposes that a page-by-page review of the first draft chapter should be carried out. However, prior to this there are number of issues where Staff seeks a confirmation of the approach or alternative directions:
  - Definition of Historical Cost;
  - Paragraphs on Suitability of Specific Measurement Bases;
  - Symbolic or Nominal Values;
  - Relocation of Material from Section of CF–ED3 on the Fair Value Model;
  - Net Selling Price; and
  - Other Issues
    - Valuation of Assets on Standalone Basis or on the Basis that They will be Used in Conjunction with other Assets/Liabilities (Unit of Account);
    - Income-based Present Value Valuation Approaches; and
    - Other Cash-Flow-Based Measures.

## Definition of Historical Cost

5. The TBG highlighted to staff that, unlike the other measurement bases, historical cost was described rather than defined in CF–ED3. Responding to this point, staff has inserted definitions of historical cost for both assets and liabilities. The definition of historical cost for an asset is :

“The amount of cash or cash equivalents paid, or the market value of the other consideration, given to acquire an asset at the time of its acquisition or construction.”
6. This definition is the same as that in the current IPSASB glossary of terms, except that “fair value” has been replaced with market value to reflect the decision at the September meeting to include “market value” rather than “fair value” as a measurement basis in the IPSASB Framework.
7. The definition of historical cost for a liability is:

“The amount of cash or cash equivalents received, or the market value of the other consideration, in the transaction under which the obligation has been assumed.”

### Matter(s) for Consideration

1. The IPSASB is asked to **confirm** that (i) historical cost should be defined for both an asset and a liability and (ii) the definitions of historical cost for an asset or a liability or **provide** other directions.

## Paragraphs on Suitability of Specific Measurement Basis

8. CF–ED3 included a sub-section on the suitability of each of the proposed current measurement bases for assets. A TBG member questioned whether, in light of the adoption of a measurement objective, these paragraphs are now necessary. Staff acknowledges the view that these paragraphs are in some cases too discursive and subjective for the final chapter; for example paragraph 3.4 on historical cost and paragraph 3.19 on market value. However, in some cases, particularly value in use, they contain important insights on characteristics of a measurement basis and on the relationship between that measurement basis and other measurement bases. Staff would be loath to lose all this material and has therefore not deleted these paragraphs in advance of a view from Members. In the view of staff it may be possible to delete the sub-section headings, but retain some of the material. The paragraphs are:
  - Historical cost: paragraph 3.4;
  - Market value: paragraphs 3.19 and 3.20;
  - Replacement cost: paragraphs 3.33 and 3.34
  - Net selling price: paragraphs 3.43 and 3.44
  - Value in use: paragraphs 3.51-3.54

**Matter(s) for Consideration**

2. The IPSASB is asked to **provide** a view whether the paragraphs on the suitability of measurement bases for assets should be deleted.

**Symbolic or Nominal Values**

9. At the September 2013 meeting one Member expressed concerns that CF–ED3 did not include “symbolic values” as a proposed measurement basis. In some jurisdictions symbolic values are known as “nominal values”. Symbolic or nominal values are used to recognize certain items on the face of the statement of financial position (or equivalent), typically heritage items, where it has not been possible to obtain a valuation or an accounting policy has been adopted that such items should not be recognized.
10. While the IPSASB did not consider that symbolic or nominal values should be included as measurement bases, Members directed staff to provide a reason(s) in the Basis for Conclusions for their non-inclusion. Staff has therefore added paragraphs BC38 and BC39 to the Basis for Conclusions. These paragraphs explain that, while the IPSASAB acknowledges that the practice of using symbolic or nominal values is a feature of accounting for certain items with some or all of the characteristics of assets in some jurisdictions in the IPSASB’s view such values do not meet the measurement objective, because they do not provide information on financial capacity, operational capacity or the cost of services. In addition they do not meet the QCs of faithful representation and relevance.

**Matter(s) for Consideration**

3. The IPSASB is asked to **confirm** that the rationale for not including symbolic or nominal values as measurement bases in paragraphs BC38 and BC39 is appropriate or **provide** alternative directions.

**Relocation of Material from Section of CF–ED3 on Fair Value Model**

11. Section 4, “Selection of Measurement Bases” of CF–ED3 described the fair value model as a method of estimating a market value when it has been determined that market value is the appropriate measure for an asset, but the market is inactive or otherwise not open or orderly. It also described the deprival value model as a method of selecting or confirming current value measurements for operational assets. At the September 2013 meeting it was agreed that Section 4, would be deleted, but that some of the material on the fair value model and insights from the deprival value model would be included in Section 3, “Measurement Bases for Assets”
12. Paragraphs 3.17 and 3.18 of the draft final chapter have been relocated from CF–ED3. One of the TBG members considers that these paragraphs, particularly paragraph 3.17, are too detailed for the Framework. Staff considers that paragraph 3.17 might be deleted, because it is too low level for the Framework, but that paragraph 3.18 contains some helpful material for standard setting and should be retained. Staff also consider that paragraph 3.18 contains a brief but useful reference to the use of cash flow estimation techniques to obtain a market value where the market is inactive or otherwise not open or orderly (see also below paragraph 19).

**Matter(s) for Consideration**

4. The IPSASB is asked to **provide** a view on whether paragraphs 3.17 and 3.18 should be retained in the draft final chapter.

**Net Selling Price**

13. Net selling price is one of the four current value measurement bases for assets. At the December meeting, staff was asked to consider the situation where, in the context of net selling price, the costs of sale are estimated to be greater than the sale proceeds. Staff's initial view is that an asset would not be presented at a negative value, but that in such cases there is a possibility of a liability arising from an onerous contract. This might arise if an entity has a contractual (or otherwise binding) obligation to sell an asset that necessitates an unavoidable sacrifice of resources.
14. In the context of selection of a measurement basis for an asset staff considers it likely that, under such a scenario, the rational approach would be to continue to use the asset and that "value in use" would be the appropriate measurement basis. Staff does not think that this scenario needs to be considered in the Basis for Conclusions, but seeks a confirmation of this view.

**Matter(s) for Consideration**

5. The IPSASB is asked to:
- **Provide** views on the brief staff analysis on the situation where in the context of net selling price the costs of sale are estimated to be greater than the sale proceeds; and
  - **Confirm** the staff view that there is no need to address this issue in the Basis for Conclusions.

**Structure of Section 4: Liabilities**

15. Unlike section 3, Section 4 on Liabilities does not include sub-sections on Suitability of the Measurement Basis and on how the measurement bases provide information on the financial capacity and operational capacity of an entity and the costs of services. The reason for this was that such an analysis would duplicate material in the discussion of assets. A TBG member has questioned the lack of symmetry in the current structure and suggested that the structure in section 4 should mirror that in section 3. Staff has some misgivings about this, because such an approach is likely to be highly repetitive. Staff seeks a view on the appropriateness of the current structure.

**Matter(s) for Consideration**

6. The IPSASB is asked to **provide** views on the structure of section 4: Liabilities, in particular whether it should mirror section 3.

## **Other Issues: Unit of Account, Income-based Present Value Valuation approaches and Other cash flow-based measures**

16. At the September meeting staff highlighted two areas identified by respondents that, in their view the Measurement chapter, should address and an issue from the IASB Discussion Paper (DP), *A Review of the Conceptual Framework for Financial Reporting*:
- Valuation of assets on standalone basis or on the basis that they will be used in conjunction with other assets/liabilities (Unit of Account);
  - Income-based present value valuation approaches; and
  - Other cash-flow-based measures.
17. Staff proposed to include references to these areas, so that the IPSASB would be cognizant of them in appropriate circumstances, when developing or revising IPSASs. Members accepted the Staff View, but also emphasized that these are standards-level issues and that additional material should be brief and not go into detail on issues such as how to perform cash flow analyses.

### *Unit of Account*

18. Staff has added paragraph 2.8 of Section 2. This paragraph notes that “in order to provide information that best meets the measurement objective and qualitative characteristics it may be necessary to aggregate assets and liabilities in the financial statements.” An assessment of whether such an aggregation is appropriate also considers whether the benefits of a particular unit of account are commensurate with the costs of determining that unit of account.

### *Income-based Present Value Valuation approaches*

19. Paragraph 3.18 of Section 3 includes a reference that in the context of estimating market value where a market is inactive or otherwise not open or orderly estimation techniques may include conversion of future cash flows to a single current discounted amount.

### *Other Cash-Flow-Based Measurements*

20. Other cash flow based measurements also involve the estimation of future cash flows. They differ from income-based present value valuation approaches, because they do not have the objective of estimating a market value or a fair value. The IASB DP identified “Other Cash-flow-based Measurements” as one of three categories of measurements<sup>1</sup>. At the September meeting Staff identified provisions, liabilities for post-employment benefits, the net realizable value of inventories and impairment of non-financial assets as areas where IPSASB has current standards where measurement requirements involve the estimation of future cash flows not designed to estimate a fair value of market value.
21. Staff has revised its view on whether it is necessary to include a specific reference to other cash-flow based measures, because they are encompassed in other measurement bases, particularly value in use for assets and cost of fulfillment for liabilities. Paragraph 3.58 notes the need for the estimating of future cash flows in the context of value in use and paragraph 4.25 acknowledges that, in the context of cost of fulfillment, “where fulfillment will not take place for an extended period, the flows need to be discounted to reflect the value of the liability at the reporting date.”

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<sup>1</sup> The other two categories are: “Cost-based Measurements” and “Current Market Prices including Fair Value”.

**Matter(s) for Consideration**

7. The IPSASB is asked to **confirm** that:
- That the references to the unit of account in paragraph 2.8 of Section 2 and to income-based present value valuation approaches in paragraph 3.18 of section 3 are adequate or **provide** alternative directions; and
  - Contrary to staff's earlier views and the direction at the September meeting there is no need to identify "other cash-flow-based measures" as a separate measurement category adequate or **provide** alternative directions.

**Conceptual Framework Exposure Draft 3**  
November 2012  
*Comments due: April 30, 2013* Final Pronouncement

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*International Public Sector Accounting Standards  
Board*

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

**IPSASB**

International Public  
Sector Accounting  
Standards Board





This document was developed and approved by the International Public Sector Accounting Standards Board (IPSASB).

The IPSASB sets International Public Sector Accounting Standards (IPSASs) for use by public sector entities, including national, regional, and local governments, and related governmental agencies.

The objective of the IPSASB is to serve the public interest by setting high-quality public sector accounting standards and by facilitating the adoption and implementation of these, thereby enhancing the quality and consistency of practice throughout the world and strengthening transparency and accountability of public sector finances.

The structures and processes that support the operations of the IPSASB are facilitated by the International Federation of Accountants (IFAC).

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## REQUEST FOR COMMENTS

The proposals in Conceptual Framework Exposure Draft 3 (CF-ED3), *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Measurement of Assets and Liabilities in Financial Statements* may be modified in light of comments received before being issued in final form. **Comments are requested by April 30, 2013.**

Respondents are asked to submit their comments electronically through the International Public Sector Accounting Standards Board (IPSASB) website, using the "Submit a Comment" link. Please submit comments in both a PDF and Word file. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website. Although IPSASB prefers that comments are submitted via its website, comments can also be sent to Stephenie Fox, IPSASB Technical Director at [stepheniefox@ipsasb.org](mailto:stepheniefox@ipsasb.org).

This publication may be downloaded free of charge from the IPSASB website: [www.ipsasb.org](http://www.ipsasb.org). The approved text is published in the English language.

### Guide for Respondents

The IPSASB welcomes comments on all the proposals in CF-ED3. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for proposed changes to CF-ED3.

### Specific Matters for Comment

The IPSASB would particularly value comments on the Specific Matters for Comment below.

#### Specific Matter for Comment 1

Do you agree that the selection of a measurement basis should be based on the extent to which a particular measurement basis meets the objectives of financial reporting? If you think that there should be a measurement objective please indicate what this measurement objective should be and give your reasons.

#### Specific Matter for Comment 2

Do you agree with the current value measurement bases for assets that have been identified in Section 3? If not, please indicate which additional measurement bases should be included or which measurement bases should not be included in the Framework?

#### Specific Matters for Comment 3

Do you agree with the approaches proposed in Section 4 for application of:

- (a) The fair value measurement model to estimate the price at which a transaction to sell an asset would take place in an active, open and orderly market at the measurement date under current market conditions. If not, please give your reasons; and
- (b) The deprival value model to select or confirm the use of a current measurement basis for operational assets. If not please give your reasons.

**Specific Matter for Comment 4**

~~Do you agree with the proposed measurement bases for liabilities in Section 5? If not, please indicate which additional measurement bases should be included or which measurement bases should not be included in the Framework?~~

## **BACKGROUND TO THE CONCEPTUAL FRAMEWORK**

### **THE CONCEPTUAL FRAMEWORK FOR GENERAL PURPOSE FINANCIAL REPORTING BY PUBLIC SECTOR ENTITIES**

#### **Introduction**

The *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the Conceptual Framework) establishes and makes explicit the concepts that are to be applied in developing International Public Sector Accounting Standards (IPSASs) and Recommended Practice Guidelines (RPGs) applicable to the preparation and presentation of general purpose financial reports (GPFRs) of public sector entities.

IPSASs are developed to apply across countries and jurisdictions with different political systems, different forms of government and different institutional and administrative arrangements for the delivery of services to constituents. The International Public Sector Accounting Standards Board (IPSASB) recognizes the diversity of forms of government, social and cultural traditions, and service delivery mechanisms that exist in the many jurisdictions that may adopt IPSASs. In developing this Conceptual Framework, the IPSASB has attempted to respond to and embrace that diversity.

#### **The Accrual Basis of Accounting**

The Conceptual Framework deals with concepts that apply to general purpose financial reporting (financial reporting) under the accrual basis of accounting.

Under the accrual basis of accounting, transactions and other events are recognized in financial statements when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognized in the financial statements of the periods to which they relate.

Financial statements prepared under the accrual basis of accounting inform users of those statements of past transactions involving the payment and receipt of cash during the reporting period, obligations to pay cash or sacrifice other resources of the entity in the future, the resources of the entity at the reporting date and changes in those obligations and resources during the reporting period. Therefore, they provide information about past transactions and other events that is more useful to users for accountability purposes and as input for decision-making than information provided by the cash basis or other bases of accounting or financial reporting.

#### **The Conceptual Framework: Chapters**

The other chapters of the Conceptual Framework are:

- Preface
- Chapter 1: The Role and Authority of the Conceptual Framework
- Chapter 2: The Objectives of Financial Reporting
- Chapter 3: The Qualitative Characteristics
- Chapter 4: The Reporting Entity
- Chapter 5: Elements and Recognition

- Chapter 7: Presentation

The *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the *Conceptual Framework*) will establish and make explicit the concepts that are to be applied in developing International Public Sector Accounting Standards (IPSASs) and other documents that provide guidance on information included in general purpose financial reports (GPFRs).

IPSASs are developed to apply across countries and jurisdictions with different political systems, different forms of government and different institutional and administrative arrangements for the delivery of services to constituents. The International Public Sector Accounting Standards Board (IPSASB) recognizes the diversity of forms of government, social and cultural traditions, and service delivery mechanisms that exist in the many jurisdictions that may adopt IPSASs. In developing this *Conceptual Framework*, the IPSASB has attempted to respond to and embrace that diversity.

### The Accrual Basis of Accounting

This Exposure Draft (ED) deals with concepts that apply to general purpose financial statements (financial statements) under the accrual basis of accounting.

Under the accrual basis of accounting, transactions and other events are recognized in financial statements when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions, events and flows are recorded in the accounting records and recognized in the financial statements of the periods to which they relate.

Financial statements prepared under the accrual basis of accounting inform users of those statements of past transactions involving the payment and receipt of cash during the reporting period, obligations to pay cash or sacrifice other resources of the entity in the future and the resources of the entity at the reporting date. Therefore, they provide information about past transactions and other events that is more useful to users for accountability purposes and as input for decision making than is information provided by the cash basis or other bases of accounting or financial reporting.

### Project Development

The IPSASB communicates *Conceptual Framework* developments to an advisory panel comprising a number of national standard setters and similar organizations with a role in establishing financial reporting requirements for governments and other public sector entities in their jurisdictions.

The purpose of the IPSASB's *Conceptual Framework* project is to develop concepts, definitions and principles that:

- Respond to the objectives, environment and circumstances of governments and other public sector entities; and therefore
- Are appropriate to guide the development of IPSASs and other documents dealing with financial reporting by public sector entities.

Many of the IPSASs currently on issue are based on International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB), to the extent that the requirements of those IFRSs are relevant to the public sector. The IPSASB's strategy also includes maintaining the alignment of IPSASs with IFRSs where appropriate for the public sector.

The IASB has a project to update and refine its *Conceptual Framework* for profit oriented entities. The IASB has recently reactivated this project following deliberations about its future work plan. Developments

in the IASB's Conceptual Framework are being monitored. However, development of the IPSASB's *Conceptual Framework* is not an IFRS convergence project, and the purpose of the IPSASB's project is not to interpret the application of the IASB Framework to the public sector.

The concepts underlying statistical financial reporting guidelines, and the potential for convergence with them, are also being considered by the IPSASB in developing its *Conceptual Framework*. The IPSASB is committed to minimizing divergence from the statistical reporting guidelines where appropriate.

### Consultation Papers and Exposure Drafts

Although all the components of the *Conceptual Framework* are interconnected, the *Conceptual Framework* project is being developed in phases. The components of the *Conceptual Framework* have been grouped as follows, and are being considered in the following sequence:

- Phase 1—the scope of financial reporting, the objectives of financial reporting and users of GPFs, the qualitative characteristics of information included in GPFs, and the reporting entity;
- Phase 2—the definition and recognition of the elements of financial statements;
- Phase 3—consideration of the measurement basis (or bases) that may validly be adopted for the elements that are recognized in the financial statements; and
- Phase 4—consideration of the concepts that should be adopted in deciding how to present financial and non financial information in GPFs.

The project initially involved the development and issue for comment of Consultation Papers (CPs) that drew out key issues and explored the ways in which those issues could be dealt with. The CP for Phase 1 (*The Objectives of Financial Reporting; The Scope of Financial Reporting; The Qualitative Characteristics of Information Included in General Purpose Financial Reports; The Reporting Entity*), was issued in September 2008. CPs dealing with Phase 2 (*Elements and Recognition in Financial Statements*) and Phase 3 (*Measurement of Assets and Liabilities in Financial Statements*) were issued in December 2010 and a CP dealing with Phase 4 (*Presentation in General Purpose Financial Reports*) was issued in January 2012. Following consideration of responses to these CPs, EDs are developed for each of the phases. The ED for Phase 1 was issued in December 2010 and, once finalized, will become the first four chapters of the *Conceptual Framework*. An ED, *Elements and Recognition in Financial Statements*, was also approved in September 2012 and was issued at the same time as this ED. A further ED will be issued on Phase 4.

**CONCEPTUAL FRAMEWORK FOR GENERAL PURPOSE FINANCIAL  
REPORTING BY PUBLIC SECTOR ENTITIES:  
MEASUREMENT OF ASSETS AND LIABILITIES IN FINANCIAL  
STATEMENTS (TO BE UPDATED)**

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CONCEPTUAL FRAMEWORK FOR GENERAL PURPOSE FINANCIAL REPORTING BY PUBLIC SECTOR ENTITIES:  
MEASUREMENT OF ASSETS AND LIABILITIES IN FINANCIAL STATEMENTS

## 1. ~~The Role of Measurement~~Introduction in the Framework

### Introduction

1.1 Accounting standards specify the ~~assets and liabilities~~elements that are recognized in financial statements and how they are measured. This ~~ED chapter~~ identifies the measurement concepts that guide the IPSASB in the selection of measurement bases for International Public Sector Accounting Standards (IPSASs), and by preparers of general purpose financial statements (financial statements) in selecting measurement bases for assets and liabilities where there are no requirements in IPSASs. The ~~ED chapter is concerned with~~identifies the measurement bases that may be used in financial statements. It does not consider application of these bases to other general purpose financial reports (GPFRs) outside the financial statements.

1.2 Because the definitions of elements are linked, the amount at which assets and liabilities are measured will affect the amount of revenue, expenses and other elements recognized. Therefore the selection of a measurement basis is important not only for the statement of financial position, but also for the reporting of elements in other financial statements.

1.3 ~~Phase 1 of the Conceptual Framework identifies service recipients and resource providers and their representatives as primary users of GPFRs and states that the objectives of financial reporting by public sector entities are "to provide information about the entity that is useful to users of GPFRs for accountability purposes and for decision making purposes." It identifies a number of specific information needs of service recipients and resource providers and their representatives. The selection of a measurement basis is particularly important to meeting the information needs of users for accountability and decision-making purposes if it enables assessments of:~~

- (a) ~~Financial capacity—the capacity of the entity to continue to fund its activities and meet its operational objectives in the future;~~
- (b) ~~Operational capacity—the physical and other resources available to support the provision of services in future periods; and~~
- (c) ~~The cost of services provided in the period;~~

~~The selection of a measurement basis may also affect assessments of:~~

- (d) ~~The capacity of the entity to adapt to changing circumstances;~~
- (e) ~~Whether current levels of taxes and other income are sufficient to maintain the volume and quality of services currently provided; and~~
- (f) ~~Whether resources have been used economically and efficiently.~~

### Qualitative Characteristics

1.4 ~~Phase 1 of the Conceptual Framework identifies the qualitative characteristics (QCs) of information included in the GPFRs of public sector entities as: faithful representation; relevance; understandability; timeliness; comparability; and verifiability. It notes the pervasive constraints on information included in GPFRs of materiality, cost benefit, and achieving an appropriate balance between the QCs. This phase also assesses the extent to which information on a particular measurement basis meets the QCs.~~

**Comment [JS1]:** Staff Note to IPSASB: This paragraph may change dependent on decisions on deferred inflows and deferred outflows in Agenda Item 6B

CONCEPTUAL FRAMEWORK FOR GENERAL PURPOSE FINANCIAL REPORTING BY PUBLIC SECTOR ENTITIES:  
MEASUREMENT OF ASSETS AND LIABILITIES IN FINANCIAL STATEMENTS

### Entry and Exit Values

- 1.5—Measurement bases may use either entry or exit values. For assets, entry values reflect the cost of purchase and exit values reflect the cost of sale. Historical cost, considered in Section 2, is an entry value basis. An exit value also reflects the amount that will be derived from the asset from its use. In a diversified economy entry and exit prices differ as entities typically acquire assets from specialized suppliers and therefore incur transaction costs. The entity cannot sell the asset at the same price as the party from which the asset was acquired, so the selling price of a recently acquired asset may differ significantly from the purchase price. This has implications for the selection of measurement bases in the public sector, because, as indicated in the ED, *Key Characteristics of the Public Sector with Potential Implications for Financial Reporting (Key Characteristics)*<sup>4</sup>, many of the assets deployed in the public sector, particularly property, plant and equipment are specialized.
- 1.6—Measurement bases for liabilities may also be classified in terms of whether they are entry or exit values. Entry values relate to the transaction under which an obligation is received or the amount that an entity would accept to assume a liability. Exit values reflect the amount required to fulfill an obligation or the amount required to release the entity from an obligation.

### Possible Measurement Bases

- 1.7—It is not possible to select a single measurement basis for financial statements that will maximize the extent to which information meets the objectives of financial reporting and the QCs. Therefore this ED does not prescribe a single measurement basis (or combination of bases). It identifies the factors that are relevant in selecting a measurement basis for particular assets and liabilities in specific circumstances.
- 1.8—The following measurement bases for assets are discussed:
- Historical cost (Section 2);
  - Market value (Section 3);
  - Replacement cost (Section 3);
  - Net selling price (Section 3); and
  - Value in use (Section 3).
- 1.9—For each basis, the discussion initially addresses the extent to which that basis can provide information for users on the areas identified in paragraph 1.3 above in order to meet the objectives of financial reporting. The discussion also addresses the extent to which the measurement basis is useful for assessing the cost of services, operational capacity and financial capacity and the extent to which it provides information that meets the QCs.
- 1.10—Section 4 discusses the fair value measurement model for estimating market value when markets are inactive and the deprival value model that may guide the selection of an appropriate measurement basis when it not clear from an initial evaluation of the objectives and QCs what measurement basis is appropriate.

<sup>4</sup> Issued by the IPSASB in April 2011.

CONCEPTUAL FRAMEWORK FOR GENERAL PURPOSE FINANCIAL REPORTING BY PUBLIC SECTOR ENTITIES:  
MEASUREMENT OF ASSETS AND LIABILITIES IN FINANCIAL STATEMENTS

**Liabilities**

~~1.11 The principles that apply to the measurement of liabilities are the same as those that apply to assets. Section 5 addresses the following measurement bases for liabilities:~~

- ~~• Historical cost;~~
- ~~• Market value;~~
- ~~• Cost of release;~~
- ~~• Assumption price; and~~
- ~~• Cost of fulfillment.~~

**Comparisons with IASB Framework and Statistical Bases of Accounting**

~~1.12 The Appendices include boxed comparisons with the International Accounting Standards Board's (IASB) Framework and comparisons with Statistical Reporting Guidelines.~~

**Comment [JS2]:** Staff Note to IPSASB: This section has been relocated to new Section. Paragraphs 1.3 (d), (e) and (f) and paragraph 1.12 have been deleted.

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## 2. The Objective of Measurement

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

2.2 The selection of a measurement basis contributes to meeting the information needs of users for accountability and decision-making purposes if it enables assessments of:

- (a) Financial capacity—the capacity of the entity to continue to fund its activities and meet its operational objectives in the future;
- (b) Operational capacity—the physical and other resources available to support the provision of services in future periods; and
- (c) The cost of services provided in the period in historical or current terms;

2.3 Chapter 3 identifies the qualitative characteristics (QCs) of information included in the GPFRs of public sector entities as: faithful representation; relevance; understandability; timeliness; comparability; and verifiability. The pervasive constraints on information included in GPFRs are materiality, cost-benefit, and achieving an appropriate balance between the QCs. In selecting a measurement basis the QCs and constraints are evaluated.

**Comment [JS3]:** Staff Note: This was the first paragraph 1.3. Sub-paragraphs 1.3(d), (e), and (f) have been deleted.

### Entry and Exit Values

2.4 Measurement bases may use either entry or exit values. For assets, entry values reflect the cost of purchase and exit values reflect the cost of sale. Historical cost is an entry value basis. An exit value also reflects the amount that will be derived from the asset from its use. In a diversified economy entry and exit prices differ as entities typically acquire assets from specialized suppliers and therefore incur transaction costs.

**Comment [JS4]:** Staff Note to IPSASB: relocation of material from first part of paragraph 1.5 in CF-ED3.

2.5 Measurement bases for liabilities may also be classified in terms of whether they are entry or exit values. Entry values relate to the transaction under which an obligation is received or the amount that an entity would accept to assume a liability. Exit values reflect the amount required to fulfill an obligation or the amount required to release the entity from an obligation.

**Comment [JS5]:** Staff Note to IPSASB: Previously paragraph 1.6 in CF-ED3. Text unchanged.

### Observable and Unobservable Measures

2.6 Measures may be classified according to whether they are observable in an open, active and orderly market. Measures that are observable in an open, active and orderly market are likely to be more understandable and verifiable than measures that are not observable in such markets. They may also be more faithfully representative of the phenomena they are measuring.

### Entity-Specific and Non-Entity Specific Measures

2.7 Measures may also be classified according to whether they are “entity-specific” or “non-entity specific”. Measurement bases that are entity-specific reflect the economic and current policy constraints that affect the possible uses of an asset and the settlement of a liability by an entity. Entity-specific measures may reflect economic opportunities that are not available to other entities. Non-entity specific measures reflect general market opportunities rather than the economic and current policy constraints. The decision on whether to use an entity-specific or non-entity specific

**Comment [JS6]:** Staff Note to IPSASB: Paragraphs 2.6 and 2.7 on (i) Observable and Unobservable Measures and (ii) Entity-Specific and non-Entity Specific Measures added. Rationale is that if Entry and Exit values are discussed these further classifications and dichotomies should also be discussed.

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measures is taken by reference to the measurement objective and the qualitative characteristics (QCs).

**Unit of account**

- 2.8 In order to provide information that best meets the measurement objective and QCs it may be necessary to aggregate assets and liabilities in the financial statements. An assessment of whether such an aggregation is appropriate also considers whether the benefits of a particular unit of account are commensurate with the costs of determining that unit of account.

**Measurement Bases and their Selection**

- 2.9 It is not possible to select a single measurement basis for financial statements that will maximize the extent to which information meets the objectives of financial reporting and the QCs. The Framework does not prescribe a single measurement basis (or combination of bases). It provides guidance on the selection of a measurement basis for particular assets and liabilities in specific circumstances in order to meet the measurement objective.

- 2.10 The following measurement bases for assets are identified and discussed in terms of (a) the suitability of the basis (b) the information they provide about (i) the cost of services delivered by an entity, (ii) the operating capacity of an entity (iii) the financial capacity of an entity; and (c) the extent to which they provide information that meets the QCs :

- Historical cost
- Market value
- Replacement cost
- Net selling price and
- Value in use

- 2.11 The following measurement bases for liabilities are identified and discussed in terms of (a) the information they provide about (i) the cost of services delivered by an entity, (ii) the operating capacity of an entity (iii) the financial capacity of an entity; and (b) the extent to which they provide information that meets the QCs ::

- Historical cost;
- Market value;
- Cost of release;
- Assumption price; and
- Cost of fulfillment.

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**Comment [JS7]:** Staff Note to the IPSASB: Added in response to direction at the September meeting.

**Comment [JS8]:** Staff Note to IPSASB: Was previously paragraph 1.7 of CF-ED3. Last sentence has been slightly modified.

**Comment [JS9]:** Staff Note to IPSASB: This paragraph will be amended if it is decided to remove or amend the section on "Suitability of (Measurement Basis).

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## 3.2. Historical Cost Measurement Bases for Assets

### Historical Cost

#### 3.1 Historical cost for an asset is defined as:

"The amount of cash or cash equivalents paid or the market value of the other consideration given to acquire an asset at the time of its acquisition or construction"

**Comment [JS10]:** Staff Note to IPSASB: Historical cost was formerly section 2 of CF-ED3. It was previously described rather than defined. A definition has been added in paragraph 3.1.

2.1-3.2 Historical cost is an entry, entity-specific value. Under the historical cost basis<sup>2</sup>, assets are initially reported at the cost incurred on their acquisition, including transaction costs. Subsequent to initial recognition, this cost is allocated as an expense to reporting periods in the form of depreciation or amortization for certain assets, as the service potential and economic benefits embodied by such assets are consumed over their useful lives.

~~2.2~~ main distinguishing feature of historical cost is that, following initial recognition, the measurement of an asset is not changed to reflect changes in prices.

~~2.3~~ Under the historical cost basis, the amount of an asset may be reduced by recognizing impairments. Impairment is the extent to which the service potential or economic benefits provided by an asset have diminished due to changes in economic conditions, as distinct to their consumption. This involves assessments of recoverability. Conversely, the amount of an asset may be increased to reflect the cost of additions and enhancements or other events, such as the accrual of interest on a financial asset.

### Suitability of Historical Cost

~~3.2.4~~ 3.4 Under the historical cost basis, revenues are compared with expenses incurred in the reporting period, including the consumption of assets used in the provision of services; this comparison enables an assessment of the entity's capacity to recover depreciation through the generation of revenues. Where capital budgets are prepared on the cost basis, historical cost information demonstrates the extent to which transactions have been in accordance with those budgets and thereby meets the objective of accountability.

**Comment [JS11]:** Staff Note to IPSASB: See Agenda Item 6C.1 on whether this paragraph and equivalent paragraphs later in this section should be retained.

### Costs of Services

~~2.4~~ 3.5 Where the historical cost basis is used, the cost of services reflects the amount of the resources expended to acquire assets consumed in the provision of services. Historical cost generally provides a direct link to the transactions actually undertaken by the entity. However, because the costs used are those carried forward from an earlier period without adjustment for price changes, they do not reflect the cost of assets either at the reporting date or at the time at which the assets are consumed. As the cost of services is reported using past prices, information prepared on a historical cost basis will not facilitate the assessment of the likely future cost of providing services if price changes are significant. The cost of assets to be acquired in the future are more likely to be similar to those of recent purchases rather than those that were made in the more distant past. Even where general prices are relatively stable, the prices applicable to specific assets may change significantly.

**Comment [JS12]:** Staff Note to IPSASB: Deleted following discussion with TBG

### Operating Capacity

<sup>2</sup> The term "historical cost" may also be referred to as "cost" or generically as "cost-based measures."

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~~2.6.3.6~~ The historical cost basis provides information on the resources available to provide services in future periods, based on their acquisition cost. At the time an asset is purchased, it can be assumed that the value to the entity of its service potential is at least as great as the cost of purchase.<sup>3</sup> ~~As noted above, When depreciation or amortization is recognized it reflects the extent to which the service potential of an asset has been consumed. If these mechanisms are effective, it can be expected that historical cost information will ensure that the resources available for future services are at least as valuable as the amount at which they are stated. However, increases in the value of an asset are not reflected under the historical cost basis. Therefore, on the basis of historical cost information, it is not possible to judge the extent to which the value of resources available to provide future services exceeds the recognized amount. This could be done by disclosure of replacement cost or value in use.~~

**Comment [JS13]:** Staff Note: Deleted on advice of TBG on grounds that Chapter should not discuss disclosure.

*Financial Capacity*

32.7 The amount at which assets are stated in financial statements assists in an assessment of financial capacity. Historical cost can provide information on the amount of assets that may be used as effective security for borrowings. An assessment of financial capacity also requires information on the amount that could be received on sale of an asset, and reinvested in assets to provide different services. Historical cost ~~is not intended to~~ does not provide this information when current exit values are significantly higher. ~~Hence when historical cost is used in the financial statements there is a case for supplementary disclosure of net selling prices.~~

**Comment [JS14]:** Staff Note to IPSASB: Deleted on grounds that Chapter should not discuss disclosure.

*Application of the Qualitative Characteristics*

32.8 Paragraphs 32.5–32.7 indicate the areas where historical cost provides relevant information in terms of its confirmatory or predictive value. Application of historical cost is often straightforward. Transaction information is usually readily available, and impairment is the exception rather than the rule. As a result amounts derived on a historical cost basis are generally representationally faithful in that they represent what they purport to represent—that is, the historical cost of the asset. Estimates of depreciation and impairment, particularly for non-cash-generating assets, can affect representational faithfulness. Because application of historical cost generally provides an indication of resources consumed by reference to actual transactions, historical cost measures are verifiable, understandable and can be prepared on a timely basis.

~~23.9~~ Historical cost information is comparable to the extent that prices at the time of acquisition are similar to those at the reporting date. Because historical cost does not reflect the impact of price changes, it is not possible to compare the amounts of assets that were acquired at different times when prices differed. ~~This difficulty arises when comparing the financial statements of entities that hold or consume assets acquired at different times as well as comparing items within the financial statements of the entity.~~

**Comment [JS15]:** Staff Note to IPSASB: Deleted following discussion with TBG.

23.10 In certain circumstances the application of historical cost necessitates the use of allocations, for example, (a) where several assets are acquired in a single transaction, (b) where assets are constructed by the entity itself and overheads and other costs have to be attributed and, (c), the use of a flow assumption, such as first-in-first-out (“FIFO”) where many similar assets are held. To

<sup>3</sup> Where this is not the case the initial historical cost measurement will be reduced by the amount of the impairment.

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the extent such allocations are arbitrary they reduce the extent to which the resulting measurement fulfills the QCs.



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### 3. Current Value Measurement Bases

3.11 ~~This section outlines~~ There are four current value measurement bases ~~for assets~~:

- Market value;
- Replacement cost;
- Net selling price; and
- Value in use.

~~Section 4 discusses two measurement models. The fair value measurement model is a mechanism for estimating market values where active markets do not exist. The deprival value model, guides the selection of replacement cost, net selling price or value in use for operational assets.~~

**Comment [JS16]:** Staff Note: Deleted due to decision to remove fair value model and deprival value model.

3.12 The following table summarizes the four measurement bases in terms of whether they use either entry or exit values, whether values are derived from observation of an open, active and orderly market and whether they are entity or non-entity specific. ~~In some cases a judgment has been made in classifying whether a particular measurement basis reflects an observable or unobservable market value and whether it is entity or non-entity specific.~~

Table 1: Summary of Current Value Measurement Bases

Measurement Basis	Entry or Exit	Observable or Unobservable in a Market	Entity or Non-entity Specific <sup>4</sup>
Market value in open, active and orderly market	Entry and exit are the same	Observable	Non-entity specific
Market value in inactive market	Exit	Dependent on valuation technique	Non-entity specific
Replacement cost	Entry	Observable	Entity specific
Net selling price	Exit	Observable	Entity specific
Value in use	Exit	Unobservable	Entity specific

#### Market Value

3.13 Market value ~~for assets~~ is defined as:

"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.~~"

3.14 At acquisition market value and historical cost will be the same, if transaction costs are ignored. The extent to which market value meets the objectives of financial reporting and the information needs of users varies depending upon the relevance of market prices to the assessments being made on the quality of the market evidence. Market evidence, in turn, depends upon the characteristics of the market in which the asset is traded. Market value is particularly appropriate

<sup>4</sup> ~~In some cases a judgment has been made in classifying whether a particular measurement basis reflects an observable or unobservable market value and whether it is entity or non-entity specific.~~

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where it is judged that the difference between entry and exit values is unlikely to be significant or the asset is being held for sale, ~~and where it is judged that the difference between entry and exit values is unlikely to be significant.~~

*Market Values in Open, Active and Orderly Markets<sup>5</sup>*

3.15 Open, active and orderly markets exhibit have the following characteristics:

- There are no barriers that prevent those who wish to transact from doing so;
- They are active so there is a sufficient frequency and volume of transactions to provide price information; and
- They are orderly with many well-informed buyers and sellers so there is assurance of “fairness” in determining current prices.

An orderly market is one that is run in a reliable, secure, accurate and efficient manner. Such markets deal in assets that are identical and therefore mutually interchangeable, such as commodities, currencies and securities where prices are publicly available. In practice few, if any, markets fully exhibit all of these characteristics, but some may approach this description.

*Market Values where it ~~c~~Cannot be Assumed that Markets are Open, Active and Orderly*

3.16 Markets for assets that are unique and rarely traded are not open, active and orderly: any purchases and sales are individually negotiated, and there may be a large range of prices at which a transaction might be agreed. Therefore participants will incur significant costs to purchase or to sell an asset. Market values therefore may reflect either an entry or exit perspective. In such circumstances it is necessary to use an estimation technique fair value model to estimate the price at which an orderly transaction to sell the asset would take place between market participants at the measurement date under current market conditions. ~~Section 4 discusses the fair value model.~~

3.17 Estimation techniques include assumptions that:

- (a) For a non-financial asset, the valuation is based on the premise that the asset will be used in its highest and best use, taking into account physical characteristics and uses that are legally permissible and financially feasible;
- (b) The transaction takes place in the principal (or most advantageous) market for the asset; and
- (c) The most appropriate valuation technique(s) for measurement is used, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the asset.

3.18 Such estimation techniques have the explicit objective of producing an exit value: they estimate the price that would be received on sale of an asset. The relevant price is that prevailing in a transaction with another market participant. This means that the model relies on observable market evidence when available. The model may however also rely on unobservable inputs where observable market evidence is unavailable. Such estimation techniques may include conversion of future cash flows to a single current discounted amount.

**Comment [JS17]:** Staff Note: With minor editorial This material has been relocated from the discussion of the Fair Value model in CF-ED3. See Agenda Item 6C.1 for discussion of whether it is too low level.

<sup>5</sup> The term “open, active and orderly markets” was developed by Dr J. Alex Milburn. See *Toward a Measurement Framework for Profit-oriented Entities*, published by the Canadian Institute of Chartered Accountants in 2012.

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Suitability of Market Value

3.197 In principle, market values provide useful information because they fairly reflect the value of the asset to the entity. In an open, active and orderly market, the asset cannot be worth less than market value (as the entity can obtain that amount by selling the asset), and cannot be worth more than market value, as the entity can obtain equivalent service potential or economic benefits by purchasing the same asset.

3.208 The usefulness of market values, ~~however~~, is more questionable when the assumption that markets are open, active and orderly is weakened. In such circumstances it cannot be assumed that the asset may be sold for the same price at which it can be acquired and ~~a fair value model is needed~~ it is necessary to estimate an exit-based market value. Exit-based market values are useful for assets that are held for trading, such as certain financial instruments, but ~~are unlikely to be~~ may not be useful for ~~many specialized~~ operational assets. Furthermore, while the purchase of an asset provides evidence that the value of the asset to the entity is at least as great as its purchase price, ~~operational because of factors related to operational capacity may mean that~~ the value to the entity may be greater. Hence market values may not reflect the value to the entity of the asset, represented by its operating capacity.

Costs of Services

3.219 Revenue from services reported in financial statements is measured on the basis of prices current in the reporting period. If assets used to provide services are measured at market value, the allocation of the cost of assets to reflect their consumption in the current reporting period ~~will be~~ based on the current market value of the asset.

3.2240 The use of market values permits ~~a return on assets to be determined the comparison of the amount received on sale of an asset with its current market value and/or current market revenue generated from the services provided by an asset with the current market value of that portion of the asset consumed in producing those services, and thus shows the extent to which the entity has obtained a return superior to that which is implicit in current market prices.~~ However, public sector activities are not generally carried out with the primary objective of generating profits, and services are often provided in non-exchange transactions or on subsidized terms, so there ~~may be~~ limited relevance in comparing the reported return to that implicit in ~~exit-based~~ market prices.

3.11 ~~An objection to the use of market values for reporting the cost of services is that the transactions actually undertaken by the entity may not be faithfully reported. If market based information is used for pricing decisions, the users of services could be charged with higher costs than those actually incurred. As noted above, transaction-based information is reported by historical cost. Information based on market values shows the cost that would be incurred, if the assets were purchased at the time the service was provided.~~

3.123.23 As noted above, revenue from services reported in financial statements is measured on the basis of prices current in the reporting period. Thus the surplus or deficit for a period reflects price movements that take place over the period during which assets and liabilities are held, and no ~~revenue profit~~ or ~~expense loss~~ is reported on the sale of an asset. Where the asset is traded on an open, active and orderly market, ~~this is an advantage as~~ the existence of the market provides assurance that the entity is able to realize the market value (and no more) at the reporting date: it is therefore unnecessary, ~~and potentially misleading~~, to postpone recognition of changes in value until a surplus is "realized" on sale. However, where assets used to provide services are not traded on

**Comment [JS18]:** Staff Note to IPSASB: See Agenda Item 6C.1 for discussion of whether this section should be retained in final chapter.

**Comment [JS19]:** Staff Note: Simplified following comments from TBG

**Comment [JS20]:** Staff Note: Deleted following view from TBG member.

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open, active and orderly markets, or a close approximation, the relevance of revenue and expenses related to changes in market value is more ~~doubtful~~questionable.

*Operating Capacity*

3.2413 Information on the market value of assets held to provide services in future periods is useful if it reflects the value that the entity is capable of deriving from assets by using them in providing or delivering services. However, if exit-based market values are significantly lower than historical cost market value is likely to be less relevant than historical cost.

*Financial Capacity*

3.2514 An ~~an~~ assessment of financial capacity requires information on the amount that would be received on sale of an asset. This information is provided by market value except where estimated market values are entry-based.

*Application of the Qualitative Characteristics*

3.2615 Values determined in open, active and orderly markets can be readily used for financial reporting purposes. The information will meet the QCs: that is it will be relevant, representationally faithful, understandable, comparable and verifiable. Under such market conditions entry and exit values can be assumed to be the same or very similar. Because it can be prepared quickly, such information is also likely to be timely.

3.2716 The extent to which market values meet the QCs will decrease as the quality of market evidence ~~decreases diminishes~~ and the determination of such values relies ~~on on the fair value model (see Section 4)~~estimation techniques. As indicated above, exit-based market values are only likely to be relevant to assessments of financial capacity and not to assessments of the cost of services and operational capacity.

**Replacement Cost**

3.2817 Replacement cost<sup>6</sup> is defined as:

"The most economic cost required for the entity to replace the service potential of an asset (including the amount that the entity will receive from its disposal at the end of its useful life) at the reporting date."

3.2918 Replacement cost differs from market value because:

- (a) In a public sector context it is explicitly an entry value;
- (b) It includes all the costs, including transaction costs, that would necessarily be incurred in the replacement of the service potential of an asset; and
- (c) It is entity specific and therefore reflects the economic position of the entity, rather than the position prevailing on a hypothetical market. For example, the replacement cost of a vehicle is less for an entity that usually acquires a large number of vehicles in a single transaction and is regularly able to negotiate discounts than for an entity that purchases vehicles

<sup>6</sup> The full term is optimized depreciated replacement cost to denote that it refers to the replacement of the service potential embodied in an asset and not the asset itself. (see paragraph 3.32) The term "replacement cost" is used for economy of expression in the Framework.

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individually. Where the replacement cost of an asset for a public sector entity differs from that of a private sector entity, it is the price prevailing in the public sector that represents replacement cost.

3.3049 Because entities usually acquire their assets by the most economic means available, replacement cost reflects the procurement or construction process that an entity generally follows. ~~The concept of r~~Replacement cost ~~reflects~~is that of the replacement of service potential in the normal course of operations, and not the costs that might be incurred if an urgent necessity arose as a result of some unforeseeable event (such as a fire).

3.2031 Replacement cost is the cost of replacing an asset's service potential. Replacement cost adopts an optimized approach and differs from reproduction cost, which is the cost of acquiring an identical asset.<sup>7</sup> Although in many cases the most economic replacement of the service potential will be by purchasing an asset that is similar to that which is controlled, replacement cost is based on an alternative asset if that alternative would provide the same service potential more cheaply. For financial reporting purposes, it is therefore necessary to make adjustments to reflect the difference in service potential between the existing and replacement asset.

3.3224 The appropriate service potential is that which the entity is capable of using or expects to use, having regard to the need to hold sufficient service capacity to deal with contingencies. Therefore the replacement cost of an asset reflects reductions in required service capacity. For example, if an entity owns a school that accommodates 500 pupils but, because of demographic changes since its construction, a school for 100 pupils would be adequate for current and reasonably foreseeable requirements, the replacement cost of the asset is that of a school for 100 pupils.

#### *Suitability of Replacement Cost*

3.3322 Replacement cost is useful for both accountability and decision-making purposes. Because it is a current value, replacement cost reflects economic conditions prevailing at the reporting date. It is also entity-specific—it reflects the economic position of the entity since all (and only) the service potential that the asset embodies is reflected in its recognized amount, and does not vary according to the value ~~or, in the case of certain specialized assets, lack of value~~—that the asset may have to another entity

3.234 In many cases the value, in terms of service potential that will be derived from an asset will be greater than its replacement cost. However, it would not be appropriate to report the asset at the value of that service potential, as they are future benefits rather than service potential at the reporting date. Replacement cost represents the highest potential value of an asset, as, by definition, the entity is able to secure equivalent service potential by incurring replacement cost.

#### *Costs of Services*

<sup>7</sup> There may be cases where replacement cost equates to reproduction cost. This is where the most economic way of replacing service potential is to reproduce the asset.

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3.3524 Replacement cost provides a relevant measure of the cost of the provision of services. The cost of consuming an asset is equivalent to the amount of the sacrifice incurred by that use. That amount is its replacement cost: the entity is able (if it is so desired) to restore its position to that prevailing immediately before the consumption of the asset by an outlay equal to replacement cost.

3.3625 The costs of services are reported in current terms when based on replacement cost. Thus the amount of assets consumed is stated at their value at the time they are consumed (and not, as with historical cost, at the time they were acquired). This provides a valid basis for a comparison between the cost of services and the amount of taxes and other revenue received in the period (which are generally transactions of the current period and measured in current prices), and for assessing whether resources have been used economically and efficiently. It also provides a useful basis for comparison with other entities that report on the same basis, and for assessing the cost of providing services in the future and future resource needs, as future costs are more likely to resemble current costs than those incurred in the past, when prices were different.

3.26 ~~In order to show the current cost of consumption, it is helpful to distinguish that cost from changes in the amount of assets that relate to price changes~~

**Comment [JS21]:** Staff Note to IPSASB:  
Deleted following comment from TBG Member.

3.27 ~~It is possible to combine historical cost and replacement cost information by reporting separately the extent to which changes in prices are reflected in the costs reported in the year. These amounts are sometimes referred to as "realized holding gains." This permits the financial statements to report both (a) the costs based on previous cash flows, as well as (b) the costs based on current resource use. Both sets of information may be useful to an assessment of accountability, and of future resource needs.~~

**Comment [JS22]:** Staff Note to IPSASB:  
Deleted following comment from TBG member

*Operating Capacity*

3.3728 ~~As noted in paragraph 3.37, in principle, replacement cost provides a useful measure of the resources available to provide services in future periods, as it is focused on the current value of assets and their service potential to the entity. Where replacement cost is used its recoverability is assessed by reference to net selling price and value in use.~~

**Comment [JS23]:** Staff Note to IPSASB: Final sentence deleted on advice of TBG

*Financial Capacity*

3.3829 ~~As noted above, an assessment of financial capacity requires information on the amount that would be received on sale of an asset. Replacement cost does not provide this information. Thus where it is used as a primary basis of financial reporting, it may usefully be supplemented by information on another basis, such as net selling price.~~

*Application of the Qualitative Characteristics*

3.390 ~~As noted above, r~~Replacement cost is ~~particularly~~ relevant to assessments of the cost of services and operational capacity. It is not relevant to assessments of financial capacity. In some cases calculation of replacement cost is complex, and subjective judgments are required. This may ~~make~~ ~~reduce the representational faithfulness the measurement of replacement cost less~~ ~~representationally faithful~~. Replacement cost information may also not be straightforward to

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understand, particularly when that information reflects a reduction in required service potential as discussed in paragraph 3.213.32 Such cases also prejudice the timeliness, comparability and verifiability of information prepared on a replacement cost basis, and will also make it more costly than some alternatives.

3.4140 Replacement cost information is comparable within an entity as assets that ~~offer~~ provide equivalent service potential ~~will be~~ stated at similar amounts, regardless of when those assets were acquired. In principle different entities may report similar assets at different amounts, because replacement cost ~~is an entity-specific measure that~~ reflects the opportunities for replacement that are available to the entity. The opportunities for replacement may be the same ~~or similar~~ for different public sector entities. Where they are different, ~~however,~~ the economic advantage of an entity that is able to acquire assets more cheaply ~~should be~~ reported in financial statements through lower asset values and a lower cost of services in order to be representationally faithful.

### Net Selling Price

3.4132 Net selling price is defined as:

"The amount that the entity can obtain from sale of the asset ~~at the reporting date~~, after deducting the costs of sale."

3.4233 Net selling price differs from market value in that ~~it is explicit that it is a sale price. Its application~~ does not require an open, active and orderly market or the estimation of a price in such a market. Net selling price therefore reflects constraints on sale. It is entity-specific.

### Suitability of Net Selling Price

3.4334 The potential usefulness of net selling price is that an asset cannot be worth less to the entity than the amount it could obtain on sale of the asset. However, it is not appropriate if the entity is able to use its resources more efficiently by employing the asset in another way, for example by using it in the delivery of services.

3.4435 Net selling price is therefore useful where the most resource-efficient course available to the entity is to sell the asset. This is the case where the asset cannot provide service potential or economic benefits at least as valuable as net selling price. Net selling price may provide useful information where an entity is contractually obligated to sell an asset at below market value. There may be cases where net selling price can indicate a development opportunity.

**Comment [JS24]:** Staff Note to IPSASB:  
Sentence inserted in response to discussion and direction at September meeting.

### Costs of Services

3.4536 It is not appropriate to quantify the cost of the provision of services at net selling prices. Such an approach would imply that assets were written down to net selling price at the time of acquisition and that the expense reported when they were consumed in the provision of services would be based on that reduced amount.

### Operating Capacity

3.4637 Stating assets held for use in the provision of services at net selling price does not provide information useful to an assessment of operating capacity. Net selling price shows the amount that could be derived from an asset's ~~sale~~, rather than the value of the service potential that could be derived from that asset.

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*Financial Capacity*

- 3.4738 As noted above, an assessment of financial capacity requires information on the amount that would be received on sale of an asset. Such information is provided by the use of net selling price. However, the lack of relevance of net selling price for assets that may yield more valuable service potential suggests that in such cases this information may be better presented as supplementary information rather than on the face of the statement of financial position.

*Application of the Qualitative Characteristics*

- 3.4839 As indicated in paragraph 3.4735 net selling price only provides relevant information where the most resource-efficient course available to the entity is to sell the asset. Assessments of net selling price are likely to be straightforward to obtain. For major assets it may be possible and cost-effective to obtain professional appraisals. Net selling price will generally provide understandable information. Although it is an entity-specific measurement basis and the extent to which it is likely to provide information that is comparable between entities, the fact that it is dependent on whether it is based on observable market values.

3.490 means that it is likely to provide information that is comparable between entities.

In most cases where net selling price is relevant, it will be adequately representationally faithful, verifiable and capable of being produced in timely manner.

**Comment [JS25]:** Staff Note to IPSASB: Statement reevaluated and modified following comment from TBG member.

**Value in Use**

- 3.5041 Value in use is defined as:

"The present value at the reporting date to the entity of the asset's remaining service potential or economic benefits if it continues to be used, and of the net amount that the entity will receive from its disposal at the end of its useful life."

*Suitability of Value in Use*

- 3.5142 Value in use is an entity-specific exit value as it reflects the amount that can be derived from an asset through its operation and its disposal at the end of its useful life. As noted in paragraph 3.23 above, the value of an asset's service potential is often greater than its replacement cost. (It is also usually greater than its historical cost.) Where this is the case, reporting an asset at its value in use would be of limited usefulness, as by definition, the entity is able to secure equivalent service potential at replacement cost.
- 3.5243 Value in use is also not an appropriate measurement basis when net selling price is greater than value in use, as in this case the most resource-efficient use of the asset is to sell it, rather than continue to use it.
- 3.5344 Therefore value in use is appropriate where it is less than replacement cost and greater than net selling price. This occurs where an asset is not worth replacing, but the value of its economic benefits or service potential is greater than its net selling price. In such circumstances value in use represents the value of the asset to the entity.
- 3.5445 Value in use is an appropriate measurement basis for the assessment of impairments, because it is used in the determination of the recoverable amount for an asset or group of assets.



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*Costs of Services, Operating Capacity, Financial Capacity*

3.5546 Because of ~~its its~~-complexity<sup>8</sup>, its limited applicability and the fact that its operationalization in a public sector context is likely to involve the use of replacement cost as an alternative, value in use is inappropriate for determining the cost of services. Its usefulness to assessments of operating capacity is limited and is only likely to be significant in the atypical circumstances where entities have a large number of assets that are not worth replacing, but the value of their service potential or economic benefits is greater than their net selling price. This may be the case if, for example, an entity will discontinue provision of a service in the future, but the proceeds of immediate sale are less than the service potential embodied in the assets. Value in use does involve an estimate of the net amount that an entity will receive from disposal of the asset. However, its limited applicability reduces-limits its suitability for assessments of financial capacity.

*Application of the Qualitative Characteristics*

3.5647 The relevance of value in use is limited to assessments of impairment and the circumstances outlined in paragraph 3.5846.

3.5748 The extent to which value in use meets the other QCs depends on how it is determined. In some cases, an asset's value in use can be quantified by calculating the value that the entity will derive from the asset assuming its continued use. This may be based on the future cash inflows related to the asset, or on cost savings that will accrue to the entity through its control of the asset. The calculation of value in use takes into account the time value of money and, in principle, the risk of variations in the amount and timing of cash flows.

3.5849 In practice, I the calculation of value in use can be complex. Assets that are employed in cash-generating activities often provide cash flows jointly with other assets. In such cases value in use can be estimated only by calculating the present value of the cash flows of a group of assets and then making an allocation to individual assets.

3.590 In the public sector, most assets contribute to the provision of services in non-exchange transactions rather than to the generation of profits: such assets are referred to as "non-cash-generating assets." Because value in use is usually derived from expected cash flows, its operationalization in such a context can be difficult. It is inappropriate to calculate value in use on the basis of cash generated for such assets, so it is therefore necessary to use replacement cost as a proxy.

3.6051 The method of determining value in use reduces its representational faithfulness. It also affects the timeliness, comparability, understandability and verifiability of information prepared on a value in use basis.

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<sup>8</sup> See below paragraph 3.58

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#### 4. Selection of Measurement Bases and Measurement Models

- 4.1 The selection of a measurement basis is primarily taken by evaluating the extent to which it contributes to the objectives of financial reporting and meets the QCs. This means that one of the measurement bases outlined in the previous sections might be selected on its own, or a model might be needed to guide the selection of an appropriate measurement basis to make an assessment of, for example, financial or operating capacity.
- 4.2 There may be cases where one measurement basis is regarded as the most appropriate basis conceptually, but, for various reasons, another measurement basis may be used as a surrogate. A measurement basis might be selected on cost-benefit grounds where it seems likely it will not usually differ from the measurement basis suggested by the discussion in this Chapter. For example, a current value measurement basis might be adopted, but a historical cost measure may be used because it is considered to be not materially different.
- 4.3 There may also be cases where a particular measurement basis requires a specific methodology to be adopted, but an alternative methodology may achieve similar results. This may be the case for example, when a methodology applied for statistical information may be sufficiently appropriate for financial reporting purposes. In both this case and the case outlined in paragraph 4.2, the use of these alternative measurement bases and methodologies is an application of, rather than a departure from, the Framework.
- 4.4 The remainder of this section considers two models that may be used in two scenarios. In the first scenario the fair value model is used to estimate a market value where it has been decided that market value is an appropriate measurement basis but an active market does not exist. In the second scenario the deprival value model can be used for selecting a current value measurement basis for operational assets.

##### Fair Value Model

- 4.5 The objective of the fair value model is to estimate the price at which a transaction to sell an asset would take place in an active, open and orderly market at the measurement date under current market conditions. The model can provide a relevant basis for assessing a financial return. Where assets are stated at fair value derived measures, financial performance can be assessed in the context of the return implicit in market values.
- 4.6 The fair value model includes assumptions that:
- (a) For a non-financial asset, the valuation is based on the premise that the asset will be used in its highest and best use, taking into account physical characteristics and uses that are legally permissible and financially feasible;
  - (b) The transaction takes place in the principal (or most advantageous) market for the asset; and
  - (c) The most appropriate valuation technique(s) for measurement is used, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the asset.
- 4.7 The fair value model has the explicit objective of producing an exit value: it estimates the price that would be received on sale of an asset. The relevant price is that prevailing in a transaction with another market participant. This means that the model relies on observable market evidence. The

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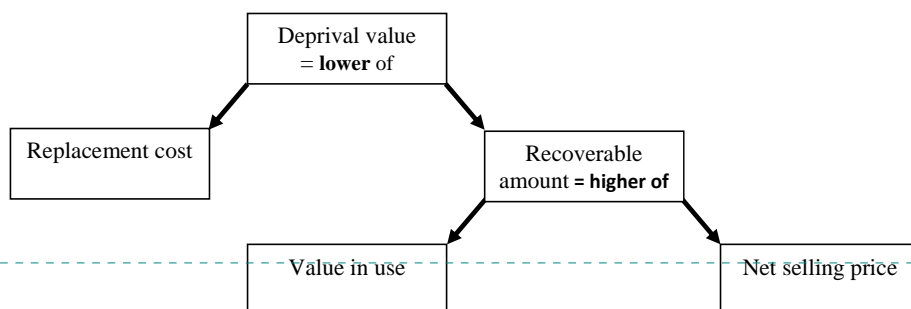
~~model may however also rely on unobservable inputs where observable market evidence is unavailable.~~

~~4.8—Unlike net selling price, fair value is not adjusted to reflect transaction costs—that is, the costs that would be incurred if the asset were to be sold.~~

#### Deprival Value Model

~~4.9—The objective of the deprival value model is to select or confirm the use of a current measurement basis. The deprival value model is based on the premise that the value of an asset to an entity (that is, its deprival value) reflects the loss that the entity would sustain if it were deprived of the asset. This may also be stated as the amount that the entity would rationally pay to acquire the asset, if it did not already control it. The model can involve consideration of up to three measurement bases—replacement cost, value in use and net selling price. Diagram 1 illustrates the model.~~

Diagram 1: Deprival Value Model



**Comment [JS26]:** Staff Note to IPSASB:  
Diagram deleted, but does not show in mark-up.

~~The value of an asset to the entity cannot be higher than replacement cost, because the entity is capable of obtaining equivalent service potential and economic benefits (including the net amount that would be received on disposal of the asset) by incurring a cost equivalent to replacement cost. However, if that service potential is not as great as replacement cost, recoverable amount is the relevant measure.~~

~~4.10—Recoverable amount is defined as the greater of value in use and net selling price. However, as value in use includes the net amount that will be received on disposal, net selling price can be seen as a limiting case of value in use, which is when the value of the remaining service potential is nil.~~

~~(a)—Net selling price is clearly relevant when the most resource-efficient use of the asset is to sell it, but is not relevant for assets, where the service potential to be derived from the asset is more valuable.~~

~~(b)—Replacement cost is not relevant where it is greater than recoverable amount.~~

~~(d)—Value in use is relevant only where it is less than replacement cost and greater than net selling price.~~

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(e) —

## 45. Measurement Bases for Liabilities

- 4.1 This section ~~reviews~~ provides the measurement bases ~~discussed in the earlier sections of this Chapter in the context of~~ liabilities. ~~As stated in paragraph 1.11, the principles that apply to the measurement of liabilities are the same as those that apply to assets. However, the significance of certain issues differs, and the terminology that is appropriate for assets needs to be adapted. This section does not replicate repeat all the discussion in Sections 2 and 3 in the context of~~ assets.
- 4.2 The measurement bases for ~~assets~~ liabilities, the corresponding terminology for liabilities and whether a basis is an entry or exit value is set out below.

Table 2: Measurement Bases for Liabilities and Corresponding Asset Terminology

Liabilities	Assets	Entry or Exit
Historical cost	Historical cost	Entry
Market value	Market value	Entry or exit
Cost of release	Net selling price	Exit
Assumption price	Replacement cost	Entry
Cost of fulfillment	Value in use	Exit

### Historical Cost

#### 4.3 Historical cost for a liability is defined as:

"The amount cash or cash equivalents received, or the market value of the other consideration, in the transaction under which the obligation has been assumed".

~~4.3 Under the historical cost measurement basis, liabilities are stated at the value of the amount received in the transaction under which the obligation is assumed.~~

- 4.4 Where the time value of a liability is material (that is, where the length of time before settlement falls due is significant), the amount of the future payment is discounted so that, at the time a liability is first recognized, it represents the value of the amount received. The discount is amortized over the life of the liability, ~~with the result~~ so that the liability is stated at the amount of the required payment when it falls due.
- 4.5 The advantages and drawbacks of using the historical cost basis for liabilities are similar to those that apply in relation to assets (see Section 32). However, historical cost cannot be applied for liabilities that do not arise from a transaction, such as a liability to pay damages for a tort or civil damages. It is also difficult to apply historical cost to liabilities that may vary in amount, such as those related to defined benefit pension liabilities.

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**Comment [JS27]:** Staff Note to IPSASB: Deleted as does not add anything to definition in new paragraph 4.3.

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## Market Value

### 4.6 Market value for liabilities is defined as:

"The amount for which a liability could be settled between knowledgeable, willing parties in an arm's length transaction"

4.64.7 Conceptually, the advantages and disadvantages of a market value for liabilities are the same as those for assets. Such a measurement basis may be appropriate, for example, for liabilities under derivative financial contracts that are traded on organized exchanges. However, in many cases, where the ability to transfer a liability is restricted and the terms on which such a transfer might be made are unclear, in such circumstances the case for market values is significantly weaker. This is particularly the case for liabilities arising from obligations in non-exchange transactions, because it is extremely unlikely that there will be an open, active and orderly market for such liabilities.

## Cost of Release

~~5.44.8~~ "Cost of release" is the term used in the context of liabilities to refer to the same concept as "net selling price" in the context of assets. Cost of release refers to the amount that relates to an immediate exit from the obligation. Cost of release is the amount that either (a) the creditor will accept in settlement of its claim, or (b) a third party would charge to accept the transfer of the liability from the obligor. Where there is more than one way of securing release from the liability, the cost of release is that of the lowest amount. (This is consistent with the approach for assets where net selling price would not reflect the amount that would be received on sale to a scrap dealer, if a higher price could be obtained from sale to a purchaser who would use the asset.)

~~5.2~~ 4.9 For some liabilities, particularly in the public sector, transfer of a liability is not practically possible and cost of release will therefore be simply the amount that the creditor will accept in settlement of its claim. This amount will be known if it is specified in the agreement with the creditor (for example, where a contract includes a specific cancellation clause).

~~5.34.10~~ In some cases there may be evidence of the price at which a liability may be transferred (for example, in the case of some pension liabilities). Transferring a liability may be distinguished from entering into an agreement with another party that will fulfill the entity's obligation or bear all the costs stemming from a liability. For a liability to be transferred it is necessary that all of the creditor's rights against the entity are extinguished. If this is not the effect of an arrangement, the liability continues to exist and remains a liability of the entity. Therefore, it should continue to be recognized by the entity. The arrangement may, however, result in a separate asset of the entity for rights established against the other party. For example, if an entity has an obligation under a lease to restore a property and pays a contractor to carry out the necessary work, payment gives rise to a right against the contractor, not a transfer of the liability (unless the lessor agrees to release the liability and obtains rights directly against the contractor).

~~5.44.11~~ In considering whether cost of release is appropriate it is necessary to consider whether release in the envisaged manner is an option that is open to the entity in practice, having regard to any consequences of obtaining release, such as damage to the entity's reputation.

~~5.54.12~~ Just as net selling price is relevant only when the most resource-efficient course available to the entity is to sell the asset, so cost of release is relevant only when the most resource-efficient course is to seek immediate release from an obligation. In particular, where cost of fulfillment is lower than

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cost of release, cost of fulfillment will ~~be provide~~ more relevant information than cost of release, even if cost of release is feasible.

#### Assumption Price

~~5-6~~ 4.13 "Assumption price" is the term used in the context of liabilities to refer to the same concept as "replacement cost" in the context of assets. Just as replacement cost represents the amount that an entity would rationally pay to acquire an asset, so assumption price is the amount which the entity would rationally be willing to accept in exchange for assuming an existing liability. Exchange transactions carried out on arms-length terms will provide evidence of assumption price; this is not the case for non-exchange transactions.

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~~5-74.14~~ In the context of an activity that is carried out with a view to profit, an entity will assume a liability only if the amount it is paid to assume the liability is greater than the cost of fulfillment or release (i.e., the settlement amount). Once that assumption price has been received by the entity, the entity has an obligation to its creditor.

~~5-84.15~~ Although typically the entity will expect to be able to fulfill its obligation and thereby extinguish its liability, it is an oversimplification to characterize the obligation as simply that of performing. More precisely, the entity's obligation is either to perform or to compensate the other party for any loss that might arise from the entity's failure to perform. Compensation would includes at least include refunding any amounts paid. Thus stating the liability at assumption price provides a representationally faithful measure, reflecting the entity's accountability to its creditor for the amount that has been paid.

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~~5-94.16~~ At the time a liability is first incurred, assumption price represents the amount that was accepted by the entity for assuming the liability: it is therefore usually reasonable to assume that assumption price is the price that the entity would rationally accept for assuming a similar liability. It would charge a higher amount, if competitive pressures allowed it to do so, but it might be unwilling to accept a lower price. Just as replacement cost is a current value so, conceptually, is assumption price. There are, however, practical problems in reflecting changes in prices in obligations that are stated at assumption price.

~~5-104.17~~ A consequence of stating performance obligations at the assumption price is that no surplus is reported at the time the obligation is taken on. A surplus or deficit is reported in the financial statements in the period when fulfillment (or release) takes place, as it is the difference between the revenue arising from satisfaction of the liability and the cost of settlement.

~~5-114.18~~ An entity may have a potential obligation that is larger than assumption price. If the entity has to seek release from a contract, the other party to the contract may be able to claim recompense for losses that it will sustain, as well as the return of any amounts paid. However, provided that the entity can settle the obligation by fulfillment, it can avoid such additional obligations and it is representationally faithful to report the obligation at no more than assumption price. (This is analogous to the position where an asset will yield greater benefits than replacement cost. Under such circumstances, as explained in Section 3, replacement cost rather than value in use is the most relevant measurement basis.)

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### Cost of Fulfillment

~~5.124.19~~ Cost of fulfillment is the current value of fulfilling the obligations represented by the liability. Where the obligation is financial, fulfillment will be making the required payments; where the obligation is to provide goods or services, fulfillment consists of providing those goods or services.

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~~5.134.20~~ ~~The c~~Cost of fulfillment includes all costs that the entity will incur in fulfilling the obligations represented by the liability, assuming that it does so in the least costly manner. The costs include not only payments to the counterparty but also other costs that will arise from fulfilling the obligation.

~~5.144.21~~ Where the cost of fulfillment depends on uncertain future events, all possible outcomes are reflected in the estimated cost of fulfillment, which should aim to reflect all those possible outcomes in an unbiased manner.

~~5.154.22~~ Where fulfillment requires work to be done—for example where the liability is to rectify environmental damage—the relevant costs are those that the entity will incur. This may be the cost of doing the work itself, or of employing a contractor to do the work on its behalf. However, the costs of employing a contractor are only relevant where employing a contractor is the least costly means of fulfilling the obligation.

~~5.164.23~~ The cost of fulfilling a liability is the value to the entity of resources that will be used in making fulfillment, and not necessarily their carrying amount at the reporting date.

~~5.174.24~~ Where fulfillment will be made by the entity itself, the fulfillment cost does not include any surplus, because any such surplus does not represent a use of the entity's resources. Where fulfillment amount is based on the cost of employing a contractor, the amount will implicitly include the profit required by the contractor, as the total amount charged by the contractor will be a demand on the entity's resources. (Similarly, for assets replacement cost would include the profit required by a supplier, but no profit would be included in the replacement cost for assets that the entity would replace by its own through self construction efforts.)

~~5.184.25~~ Where fulfillment will not take place for an extended period, the costs flows need to be discounted to reflect the value of the liability at the reporting date.

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~~5.19~~ 4.26 Cost of fulfillment is generally relevant except in the following circumstances:

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- (a) Where the entity can obtain release from an obligation at a lower amount than cost of fulfillment, then cost of release is a more relevant measure of the current burden of a liability. (Just as, for an asset, net selling price is more relevant when it is higher than value in use.)
- (b) In the case of liabilities assumed for a consideration, assumption price is more relevant when assumption price is higher than both cost of fulfillment and cost of release.<sup>9</sup>

<sup>9</sup> The principles in the deprival value model in Section 4 are reflected in the relief value model, which can guide the selection of assumption price, cost of fulfillment or cost of release as an appropriate measurement basis for liabilities. The relief value model is discussed in the Consultation Paper, *Measurement of Assets and Liabilities in Financial Statements*, issued by the IPSASB in December 2010.

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## Basis for Conclusions

*This Basis for Conclusions accompanies, but does not form part of, the Conceptual Framework.*

### **Section 1: Section 1- The Role of Measurement in the Framework**

BC1. When the IPSASB initiated Phase 3 of the Framework project, the IPSASB decided that the initial focus should be on measurement of the elements for the financial statements. The IPSASB acknowledges that there ~~will be~~ a need to consider the measurement of other elements in the GPFRs outside the financial statements. However, in order to put future standard setting activities for the financial statements on a sound and transparent footing, ~~the IPSASB decided it is important to deal firstly with the~~ develop ~~firstly~~ment of measurement approaches for the financial statements, ~~while acknowledging that elements for areas of financial reporting outside the financial statements will need to be developed in the future.~~

### **Section 2: A Measurement Objective**

BC2. ~~In December 2010, the IPSASB published a Consultation Paper, Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Measurement of Assets and Liabilities in Financial Statements (CF-CP3). This Exposure Draft has been developed after further deliberations by the IPSASB, including consideration of the responses received to CF-CP3. The IPSASB considered whether a specific measurement objective should be developed. The IPSASB initially took the view that a separate measurement objective was unnecessary, because The IPSASB decided that specifying an overall measurement objective related to a measurement basis would lead to the risk of the measurement objective might competeing with, rather than complementing, the objectives of financial reporting and the QCs specified in Phase 1 of the Framework<sup>10</sup>. Accordingly, Exposure Draft, Elements and Recognition in Financial Statements (CF-ED3) the Framework relateds the factors relevant to the selection of a measurement basis to the objectives of financial reporting and the QCs, but did not include a measurement objective specified in Phase 1 of the Framework.~~

BC3.

BC4-BC3. ~~Consistent with this approach CF-ED3 CF-CP3~~ envisaged that the Framework would not seek to identify a single measurement basis (or combination of bases) for all circumstances. ~~Rather CF-CP3 proposed that the Framework should discuss factors relevant to selecting the measurement basis to be required for particular assets and liabilities in specific circumstances. CF-CP3~~ The IPSASB acknowledged that requiring a single measurement basis to be used in all circumstances would clarify the relationship between different amounts reported in the financial statements: in particular, the amounts of different assets and liabilities could be aggregated to provide meaningful totals. However, ~~the IPSASB~~ ~~re took the view that there~~ is no single measurement basis that will maximize the extent to which financial statements meet the objectives of financial reporting and fulfill the QCs.

BC4. CF-ED3 included an Alternative View (AV), which proposed a measurement objective on the grounds that a Conceptual Framework that does not connect the objective of measurement

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<sup>10</sup> Subsequently Chapters 2 and 3.



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with the objectives of financial reporting is incomplete and will limit the ability of the IPSASB to make consistent decisions about measurement across financial reporting standards and over time. Further, in the absence of a measurement objective, the AV considered that there is a risk that different and/or inappropriate measurement bases could be used to measure similar classes of assets and liabilities. The AV proposed the following measurement 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.”*

BC5. Many Some respondents, while generally in favor of the supporting the general approach in CF-EDCP3, supported the AV. The IPSASB also acknowledged the view that the Framework’s approach to measurement should be aspirational and that the Framework should identify a single measurement basis underpinned by an ideal concept of capital<sup>11</sup>. The IPSASB accepted that the operating capability concept is relevant for public sector entities whose primary objective is the delivery of services. However, adoption of such a measurement objective involves a virtually explicit acknowledgement that current cost measures are superior to historical cost. For the reasons given below the IPSASB considers that historical cost measures often meet the measurement objective and therefore should be given appropriate emphasis in the Framework.

BC6. The IPSASB was persuaded by the views of those who argue that a measurement objective is necessary in order to guide standard-level decisions on the selection of measurement bases. However, the IPSASB noted that assets and liabilities contribute to the financial performance and financial position of entities in different ways and that such an assessment should be based on the extent to which they contribute to financial capacity and operational capacity. The IPSASB concluded that linking a measurement basis to an ideal concept of capital might unduly restrict the choice of measurement bases. The IPSASB therefore rejected the view that adoption of measurement objective should be based on an ideal concept of capital suggested that the selection of a measurement basis should be guided by a single measurement objective, such as providing the value to the entity at the reporting date. The IPSASB decided not to pursue this approach as it might unduly restrict the choice of measurement bases and reaffirmed its view that a mixed measurement approach is appropriate in the public sector.

BC7. –The IPSASB therefore considered whether the measurement objective proposed in the AV was appropriate. Some argued that the proposed measurement objective was too aligned to current value measures. However the IPSASB formed a view that reference to “cost of services” provide a sufficient link to historical cost, because the cost of services can be determined using both historical cost and current value measures. The IPSASB therefore adopted the following measurement objective with only a minor modification from that proposed in the AV:

<sup>11</sup> Such concepts of capital include invested money capital, current cash equivalents and operating capability

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

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~~BC5. The IPSASB decided that specifying an overall measurement objective related to a measurement basis would lead to the risk of the measurement objective competing with, rather than complementing, the objectives of financial reporting and the QCs. Accordingly, the Framework relates the factors relevant to the selection of a measurement basis to the objectives of financial reporting and the QCs specified in Phase 1 of the Framework.~~

BC6. BC8 The IPSASB also noted that the disadvantages of using different measurement bases may be minimized by:

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- (a) Selecting different measurement bases only where this is justified by economic circumstances, thereby ensuring that assets and liabilities are reported on the same basis where circumstances are similar; and
- (b) Requiring transparent presentation and disclosure to ensure that the measurement bases used and the amounts reported on each basis are clear.

#### Possible Measurement Bases

~~BC7. The Chapter aims to be complete by discussing the measurement bases that need to be considered in the development of an IPSAS and the selection of an accounting policy by preparers in the absence of an IPSAS. The measurement bases that are addressed in this Chapter include those that are often used in practice or advocated in theory.~~

~~BC8. CF CP3 discussed a range of measurement bases. It considered the attributes/usefulness of: historical cost; market value and replacement cost. In addition, it considered value in use and net selling price in the context of the deprival value model. Respondents to CF-CP3 generally agreed that these were the most relevant bases. The IPSASB agreed that the Framework should discuss all of these measurement bases outlined in CF-CP3. Some respondents suggested that fair value should also be considered. Fair value is discussed further below. The Chapter aims to provide useful guidance for the selection of a measurement basis but it does not aim to be determinative. In many circumstances it will remain a matter of judgment as to which measurement basis most effectively meets the objectives of financial reporting, satisfies users' information needs and secures the best balance between the QCs.~~

#### Initial and Subsequent Measurement

BC9. BC9 A measurement basis needs to be selected both when an asset or liability is recognized for the first time (initial measurement) and when it is reported in the financial statements of a later period (subsequent measurement). Some accounting policies are expressed in a way that may suggest that different principles apply to initial and subsequent measurement. For example, an asset may initially be recognized at transaction price and subsequently at a current value. The IPSASB therefore considered whether the ED-Framework should discuss initial and subsequent measurement separately.

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BC10. BC10 One reason why different measurement bases may be specified for initial and subsequent recognition is that the basis to be used for subsequent recognition is not available at

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the time of initial recognition. This is particularly common in the public sector where assets are sometimes contributed, or provided on subsidized terms, or in exchange for other non-cash assets. In such a case the value of the transaction may be unknown, and if the asset is to be subsequently accounted for at an entry value such as historical cost or replacement cost, another basis has to be specified for use on initial recognition as a surrogate for the amount at which the asset would be stated if purchased on arm's-length terms. Surrogates may also be required for the initial recognition of assets acquired before the introduction of accrual accounting where the transaction price is not known. ~~As stated above, the~~ sensible use of surrogates that meet the measurement objective and the QCs is an application of a measurement basis rather than a departure from it.

BC11. BC11 Another reason for an apparent difference in initial and subsequent measurement arises where an asset is to be accounted for at a current value, and the transaction price is deemed to reflect the particular current measurement basis that will be used. In such a case, specifying that the asset is to be initially recognised at transaction price makes it clear that that application of the policy will not result in the recognition of revenue on initial recognition ("day one" gains or losses). In principle, the same measurement basis is used for both initial and subsequent recognition: the requirements for each are specified differently in order to assist understanding.

BC12. BC12 The IPSASB concluded that, in principle, the same considerations apply to initial and subsequent measurement. Accordingly the discussion in this ED-Chapter is applicable to both situations.

## Section 32: Historical Cost Measurement Bases for Assets

### Historical Cost

BC13. BC13 Historical cost is a widely applied measurement basis ~~that is firmly embedded~~ in the financial reporting of the public sector in many jurisdictions. Many respondents to the Consultation Paper, Elements and Recognition in Financial Statements (CF-CP3) and CF-ED3 supported the continued widespread use of historical cost as a measurement basis, mostly in combination with other measurement bases. They supported this view by reference to accountability objective and the simplicity understandability and verifiability of historical cost. ~~Supporters of historical cost also consider that the link between historical cost and the transactions actually undertaken by the entity is particularly important for an assessment of accountability.~~ They also noted that, because historical cost is widely ~~used~~ adopted under current practice, its continued use avoids the costs that would arise if a revised standard were to require the use of a different measurement basis.

BC14. BC14 The IPSASB agreed that historical cost is generally understandable and verifiable and that where it is used under current practice, a change to another measurement basis should be required only where it is judged that the benefits of doing so outweigh the costs of change.

BC15 Some respondents considered ~~ed~~ ed that historical cost information provides a highly relevant basis for the reporting of the cost of services. Supporters of historical cost consider that the link between historical cost and the transactions actually undertaken by the entity is particularly important for an assessment of accountability; in particular, historical cost provides information that resource providers can use to assess the fairness of the taxes they have been assessed or have otherwise contributed in a reporting period, thereby enhancing accountability.

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BC16. The IPSASB agreed that, in many contexts, it is relevant to provide information on the transactions actually carried out by the entity, because and accepted that users are particularly interested in the cost of services based on actual transactions. Because hHistorical cost provides information on what services actually cost in the reporting period, rather than what they will cost in the future; pricing decisions based on historical cost information may promote fairness to consumers of service.

BC15. BC17. The IPSASB also acknowledged the views of those who consider that tSome respondents agreed with the suggestion made in CF-CP3 that the use of historical cost facilitated a comparison of the actual financial results and the approved budget. The IPSASB acknowledges scepts that budgets may often in practice be prepared on a historical cost basis and that where this is the case historical cost enhances comparison against budget. However, bBudgets may also reflect anticipated prices during a reporting period.

BC16. BC18. The IPSASB also acknowledged a contrary view: that However, another approach to assessing and reporting the cost of providing services in terms of the value that has been sacrificed in order to provide those services provides useful information for both decision making and accountability purposes. Because historical cost does not reflect the value of assets at the time they are consumed, it does not provide information on that value in circumstances where the effect of price changes is significant. The IPSASB concluded that #it is important that the Framework acknowledges-responds to both these contrasting perspectives.

BC17. Some respondents agreed with the suggestion made in CF-CP3 that the use of historical cost facilitated a comparison of the actual results and the approved budget. The IPSASB acknowledges that budgets may often in practice be prepared on a historical cost basis and that where this is the case historical cost enhances comparison against budget. Budgets may also reflect anticipated prices during a period.

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### Section 3: Current Value Measurement Bases

#### Market Value and Fair Values

BC18. BC19. CF-ED3CP3 did not discuss-propose fair value as a measurement basis. Rather it proposed market value, which was defined in the same way as fair value in the IPSASB's literature at the time the Conceptual Framework was developed. A number of respondents challenged the failure to propose fair value as a measurement basis and to define fair value. They pointed out that fair value is a measurement basis that is defined and used in specifying measurement requirements by many global and national standard setters and that a definition of fair value based on the IASB's pre-IFRS 13 definition of fair valueit had been used extensively in IPSASB's existing literature. They further highlighted the that, although the pronouncement does not form part of itsdefinition of fair value-Conceptual Framework project, the IASB issued in IFRS 13, Fair Value Measurement, issued in May 2011. Such respondents considered that the IPSASB's Conceptual Framework should include fair value as a potential measurement basis and that the definition should mirror that in IFRS 13.<sup>12</sup>

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<sup>12</sup> The definition in IFRS 13 was used as the definition of fair value in the IASB's Discussion Paper, which characterized fair value as "the most frequently used current value measurement."

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- BC19. BC20. The IPSASB's rationale for the approach proposed in CF-ED3 was that fair value is very similar to market value and the inclusion of both measurement bases is likely to be confusing to the users of financial statements. The IPSASB also noted that fair value, as defined in IFRS 13 is explicitly an exit value. and that therefore the relevance of fair value in the public sector is likely to be primarily limited to meeting the objective of reporting related to providing information on financial capacity, rather than on providing information on the cost of services and operating capacity. In addition, replacement cost (referred to as the cost approach in IFRS 13) is used as a valuation technique in IFRS 13 to estimate fair value. In the context of IFRS 13 replacement cost is used as a surrogate to determine an exit value. In this ~~ED~~chapter replacement cost is proposed as an entity-specific, entry-value measurement basis in its own right.
- BC20. BC21. In the public sector many assets are specialized and differences in entry and exit prices are therefore significant. Where an asset will provide service potential or other economic benefits that are greater than its exit price, a measure reflecting exit values is not the most relevant basis. Where the most resource efficient course is to sell the asset (because the service potential or economic benefits that it will provide is not as great as can be received from sale, the most relevant measurement basis is likely to be net selling price, which reflects the costs of sale and, although likely to be based on market evidence, does not assume the existence of an active, open and orderly market).
- BC21. BC22. In considering the merits of fair value (as used in IFRS 13) as a measurement basis, the IPSASB accepted that fair value provides a relevant basis for assessing a financial return. Where assets are stated at fair value, financial performance can be assessed in the context of the return implicit in market values. However, public sector activities are not generally carried out with a view to obtaining a financial return, so the relevance of assessing any such return in the context of a market setting seems slight.
- BC23. In finalizing the measurement chapter ~~the~~ The IPSASB considered three main options in dealing with this issue:
- (i) Adopt the IFRS definition of fair value;
  - (ii) Retain its current definition of fair value; or
  - (iii) Remove fair value as a measurement basis altogether as proposed in CF-ED3.
- BC24. Adopting the IFRS definition would have meant using a definition of fair value that is not well aligned with the objectives of most public sector entities – the delivery of services rather than the generation of cash flows. It is questionable whether measures based on the current IFRS definition would provide relevant information for many assets held for their operational capacity and for liabilities arising from non-exchange transactions where it is not feasible to transfer the liability. However, the IPSASB acknowledged that adopting the IASB definition of fair value would make the maintenance of alignment with IFRS more straightforward in the future.
- BC25. Retaining the IPSASB's current definition of fair value or a slightly modified version of the current definition in the IPSASB literature would have meant that two global standard setters would have different definitions of the same term.
- BC26. The non-inclusion of fair value would have implications for the IPSASB's extant literature at the time the Framework was finalized, because a number of IPSAS's contained fair value in measurement requirements or options.

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~~BC22.~~ BC27. The IPSASB acknowledged that its approach to fair value at a standards level had not kept pace with global developments since its definition of fair value had been first adopted and recognized that all the above options have disadvantages. On balance the ~~he~~ IPSASB concluded that, rather than include an exit-based definition of fair value, or a public sector specific definition that differs from that in IFRS 13 should not be proposed as a measurement basis. ~~However, fair value is a useful measurement model for the estimation of market value where it has been determined that market value is the most appropriate measurement basis, but the market is inactive. Therefore discussion of the fair value model is included in Section 4. Therefore the IPSASB decided to include market value as a measurement basis in the Framework.~~

~~BC23.~~ CF-CP3 discussed "market value" as a possible measurement basis. The IPSASB considered using the term "current exchange value" instead of market value, in order to indicate that the Framework addresses both the circumstances where markets are open, active and orderly and circumstances where market values have to be estimated because observable market evidence is either limited or unavailable. However, the IPSASB decided that, although it can be ambiguous in a public sector context, "market value" is a widely used and understood term and it should be retained in the Framework.

**Replacement Cost, Net Selling Price and Value in Use**

~~BC24.~~ BC28. As discussed in *Key Characteristics* ~~the Preface to the Conceptual Framework~~ the objective of public sector entities is to deliver goods and services, often in non-exchange transactions, rather than to generate profits. Therefore many non-financial assets are held for operational purposes. Furthermore, many of these assets are specialized and unlikely to be purchased or sold in open, active and orderly markets. ~~While the market value basis~~ Market value is useful for enabling ~~facilitates~~ an assessment of financial capacity and operational capacity where operational assets are not specialized and traded in open, active and orderly markets. ~~However,~~ current measurement bases other than market value are necessary in order to provide useful information on the cost of services and operational capacity where assets are specialized and where market-based information is limited.

~~BC25.~~ BC29. In evaluating measurement bases that provide the most useful information for specialized operational assets the IPSASB sought a basis that reflects the continuing provision of goods and services by public sector entities. The most appropriate basis for such assets is one that provides information on the cost of future service potential that is attributable to an asset.

~~BC26.~~ BC30. The IPSASB considered reproduction cost as a potential measurement basis. Reproduction cost is easily understandable. However, it reflects the cost of obtaining an identical asset, rather than the cost of replacing the service potential provided by an asset. Therefore reproduction cost may reflect features of assets that no longer serve any economic purpose and its use may exaggerate the value of an asset. Replacement cost avoids this risk because it is based on the most economic cost required for the entity to replace the service potential of an asset. While accepting that the calculation of replacement cost may in some cases be complex and involve subjective judgments the IPSASB concluded that replacement cost is the measurement basis that often ~~provides the most useful information~~ best meets the measurement objective and ~~best meets~~ the QCs.

~~BC27.~~ BC31. The IPSASB acknowledged that replacement cost will not always be an appropriate measurement basis for specialized operational assets. There may be circumstances where an entity no longer intends to continue to operate an asset. In such circumstances replacement cost is not a useful measurement basis, because it would not be rational for the entity to replace the

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service potential provided by an asset. The IPSASB therefore considered the appropriate measurement basis for such circumstances. It considered fair value less costs to sell, noting that such a measurement basis aims to reflect conditions in an open, active and orderly market. However the IPSASB concluded that an entity specific measurement basis that reflects the constraints on sale for an entity is more appropriate. The IPSASB concluded that net selling price is the most appropriate basis. Net selling price is therefore considered in Section 3 included as a measurement basis in section 3 of this chapter. Net selling price can be distinguished from market value because net selling price does not assume an open, active and orderly market. Net selling price also provides information that meets the measurement objective, where an entity is contractually required, or in a binding arrangement, to sell an asset at below market value, perhaps in order to meet a social or political objective.

**BC28.** BC32. In order to provide a complete analysis of the circumstances under which public sector entities operate the IPSASB also considered the situation where it would not be rational for an entity to seek to replace the service potential embodied in an asset, but it is still more rational for the entity to continue to operate the asset than to sell it immediately. The IPSASB therefore concluded that value in use should be included as a potential measurement basis. The IPSASB acknowledged that this measurement basis is not straightforward to operationalize in a non-cash-generating public sector context, and that it might therefore be necessary to use replacement cost as a surrogate.

**BC29.** The selection of a measurement basis should optimally be made on the basis of an evaluation of the extent to which it contributes to the objectives of financial reporting and meets the QCs. However, the IPSASB acknowledged that such a decision may not be straightforward and that the deprival value model might provide further insights into the decision how to select a current value measurement basis for operational assets. The deprival value model is therefore considered in Section 4.

## Section 4: Selection of Measurement Bases and Measurement Models

### Fair Value Model

**BC30.** BC33. While CF-ED3 did not propose fair value as a measurement basis in its own right it proposed the fair value measurement model as a method of determining market value where it has been decided that market value is the appropriate measurement basis, but the market is inactive or otherwise not open or orderly. CF-CP3 did not discuss fair value. A number of respondents pointed out that fair value is a measurement basis that is defined and used in specifying measurement requirements by many global and national standard setters and that it has been used extensively in IPSASB's existing literature. They further highlighted that, although the pronouncement does not form part of its Conceptual Framework project, the IASB issued IFRS 13, *Fair Value Measurement*, in May 2011. Such respondents considered that the IPSASB's Conceptual Framework should include fair value as a potential measurement basis.

**BC31.** Fair value is very similar to market value and the inclusion of both measurement bases is likely to be confusing. The IPSASB also noted that fair value, as defined in IFRS 13 is explicitly an exit value and that therefore the relevance of fair value in the public sector is likely to be limited to meeting the objective of reporting related to information on financial capacity, rather than on providing information on the cost of services and operating capacity. In addition, replacement cost (referred to as the cost approach in IFRS 13) is used as a valuation technique in IFRS 13 to

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~~estimate fair value. In the context of IFRS 13 replacement cost is used as a surrogate to determine an exit value. In this ED replacement cost is proposed as an entity specific, entry value measurement basis in its own right.~~

~~BC32. BC34. A number of respondents to CF–ED3 expressed a view that the fair value model is too low level for the Conceptual Framework. Views were also expressed that not including fair value as a measurement basis and this was exacerbated by the fact that the phrase “Fair Value Model” is used in IPSASB’s current literature. The IPSASB was persuaded by these views and decided not to include the fair value model in the Framework. The discussion of market value in Section 3 includes a high-level acknowledgement that where a market is not open, active and orderly estimation techniques need to be used. Optimally such techniques will be based on observable market data, but non-observable data may be used where observable market data is unavailable. In the public sector many assets are specialized and differences in entry and exit prices are therefore significant. Where an asset will provide service potential or other economic benefits that are greater than its exit price, a measure reflecting exit values is not the most relevant basis. Where the most resource efficient course is to sell the asset (because the service potential or economic benefits that it will provide is not as great as can be received from sale, the most relevant measurement basis is likely to be net selling price, which reflects the costs of sale).~~

~~BC33. In considering the merits of fair value (as used in IFRS 13) as a measurement basis, the IPSASB accepted that fair value provides a relevant basis for assessing a financial return. Where assets are stated at fair value, financial performance can be assessed in the context of the return implicit in market values. However, public sector activities are not generally carried out with a view to obtaining a financial return, so the relevance of assessing any such return in the context of a market setting seems slight.~~

~~BC34. The IPSASB concluded that fair value should not be proposed as a measurement basis. However, fair value is a useful measurement model for the estimation of market value where it has been determined that market value is the most appropriate measurement basis, but the market is inactive. Therefore discussion of the fair value model is included in Section 4.~~

#### Deprival Value Model

~~BC35. BC35. CF-CP3 discussed the deprival value model as providing a rationale by which a specific current value basis may be selected as the most relevant in specified circumstances. Some respondents expressed reservations about the use of the deprival value model that was discussed in CF–CP3; in particular that it would be costly and impose a disproportionate burden on preparers to have to consider three possible measurement bases for each asset that is reported. A number of respondents also considered that it is over complex. The IPSASB also accepted a view that the deprival value model unduly exaggerates the QC of relevance and neglects the other QCs.~~

~~BC36. While the IPSASB acknowledged such reservations while recognizing that the deprival value model has been adopted successfully in some jurisdictions, the IPSASB concluded that it would not usually be practicable for an accounting standard simply to require the use of the deprival value model for selection of the appropriate measurement basis. However, the IPSASB concluded that the deprival value model contains useful insights into the selection of a current value measurement basis and, in particular, can be used to assess the relevance of three measurement bases for operational assets – replacement cost, net selling price and value in use – where an initial evaluation of the objectives of financial reporting and the QCs does not lead~~

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~~to the selection of a particular measurement basis. The IPSASB therefore decided to include a discussion on the deprival value model in CF-ED3 as an optional method of choosing between replacement cost, net selling price and value in use where the appropriate measurement basis could not be identified by reference to the objectives of financial reporting and the QCs~~

BC36. ~~BC37. While a minority of respondents are highly supportive of the deprival value model in Section 4.~~

~~The IPSASB emphasized that the deprival value model addresses only the relevance of particular measurement bases and that the objectives of financial reporting and the other qualitative characteristics are the primary considerations in the selection of a measurement basis. For example, where the deprival value model suggests that replacement cost is the most relevant basis, historical cost may be preferred because of the emphasis placed on the accountability that a reliance on actual transactions provides and its understandability and verifiability. Any respondents to CF-ED3 continued to express reservations about the complexity of the deprival value model. The IPSASB also acknowledged a technical ambiguity in the deprival value model that if net selling price is higher than replacement cost a development opportunity might be indicated and that users should be provided with this information, which the deprival value model would not do. Due to these factors the IPSASB decided not to include the deprival value model in the Framework, while retaining some of the insights provided by the model in its analysis of replacement cost, net selling price and value in use; for example, that it is inappropriate to measure an asset at replacement cost if either net selling price or value in use is lower.~~

#### Symbolic Values

~~BC38. In some jurisdictions certain assets, often heritage assets, are recognized on the statement of financial position at symbolic or nominal values, typically one unit of the presentation currency. This treatment is adopted in order to recognize assets on the statement of financial position in circumstances where it is difficult to obtain a valuation or where an accounting policy has been adopted that such items should not be valued.~~

BC37. ~~BC39. The accounting treatment for heritage assets is a standards level issue. However, the IPSASB took the view that symbolic or nominal approaches do not meet the measurement objective, because they do not provide information on financial capacity, operational capacity or the cost of services. In addition they do not meet the QCs of faithful representation and relevance. The decision whether to recognize an item as an asset should be made following an assessment of whether the item meets the asset definition and recognition criteria in Chapter 5.~~

### **Section 54: Measurement Bases for Liabilities**

BC38. ~~BC40. While few respondents to CF-CP3 discussed the measurement of liabilities, the IPSASB concluded that the principles of measurement that apply to assets are equally applicable to liabilities. The discussion in Section 45 adapts the terminology and seeks to explain the necessary differences of emphasis. The IPSASB acknowledged the views of those who noted that, because, as highlighted in Key Characteristics, the Preface to the Conceptual Framework, many goods and services are provided by public sector entities in non-exchange transactions there will often not be an assumption price. Furthermore, there is unlikely to be a cost of release, because the creditor is unlikely to accept a sum lower than cost of fulfillment in settlement; and instances where a third party would accept the transfer of such a liability from the obligor for a specified amount are likely to be rare. Therefore liabilities arising from non-exchange transactions~~

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are likely to be measured at the cost of fulfillment, and this will often be the only practical and relevant measurement basis. Nevertheless the IPSASB decided to retain the cost of assumption and the cost of release as there may be limited circumstances where these measurement bases meet the measurement objective.

The analysis of the various measurement bases and the circumstances in which they may be relevant are consistent with the relief value model that was discussed in CF-CP3.

**Other Issues**

**BC39.** BC41. CF-CP3 sought the views of respondents on the following two issues related to measurement:

- (a) The treatment of an entity's own credit risk and changes in value attributable to changes in an entity's own credit risk; and
- (b) Whether the measurement of an asset should reflect only the service potential relating to its existing use, or whether the measurement of an asset should include the incremental value relating to its possible alternative use.

**BC40.** BC42. The majority of respondents who provided comments on these issues considered that they were more appropriately dealt with at the standards level than within the Framework. The IPSASB concurred with this view, and these issues are accordingly not dealt with in this Eaddressed in the Framework. The IPSASB noted that where a market value is used to measure a liability it is necessary to consider the treatment of the entity's own credit risk.

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**Alternative View of Mr. Ken Warren**

- ~~AV1. The role of the Conceptual Framework is to establish the concepts that the International Public Sector Accounting Standards Board (IPSASB) will apply in developing International Public Sector Accounting Standards (this objective is set out in Phase 1 of the Framework). To successfully perform this role, the Conceptual Framework needs to integrate, in a coherent way, the objectives and qualitative characteristics (QCs) of financial reporting, the essential characteristics of the elements, the methodologies used to measure the elements and the manner in which the elements and other information are presented in financial reports.~~
- ~~AV1. As a standard setter the IPSASB decides whether an item of information should be recognized in the financial statements, when such an item should be recognized, and at what amount it should be recognized. For the IPSASB to make consistent decisions in developing standards, it is necessary to have (a) definitions of the elements of financial statements, (b) a basis for determining when elements of financial statements should be recognized in the financial statements, and (c) a basis for determining which measurement approach (for example, initial amounts, remeasured amounts, entry or exit notions) is appropriate for reporting the elements.~~
- ~~AV2. In developing the Measurement ED of its Conceptual Framework the IPSASB has decided not to identify a measurement objective on the basis that this might unduly restrict the choice of measurement bases, and could result in a measurement objective that competes with, rather than complements, the overall objectives of financial reporting and the QCs (Basis of Conclusions: Paragraph BC 4 refers).~~
- ~~AV3. In this member's opinion a measurement objective is required. A Conceptual Framework that does not connect the objective of measurement with the objectives of financial reporting is incomplete and will limit the ability of the IPSASB to make consistent decisions about measurement across financial reporting standards and over time. Moreover, in the absence of a measurement objective, there is a risk that different and/or inappropriate measurement bases could be used to measure similar classes of assets and liabilities.~~
- ~~AV4. This member considers that, rather than being in competition, a measurement objective is necessary to connect the overall objectives of financial reporting and the QCs to decisions on which measurement basis or model to choose. It is important to assess whether information provided by the measurement basis or model that has been chosen meets the overall objectives of financial reporting and the QCs. This alternative view explains how a measurement objective could provide useful criteria for the IPSASB to consider when developing standards that impact on measurement, and how the IPSASB's concerns regarding a measurement objective could be addressed.~~

**A Measurement Objective**

- ~~AV5. To develop a measurement objective it is necessary to look first at the objectives of financial reporting. The objectives of financial reporting, as identified in the developing IPSASB Framework, are to meet the information needs of users for accountability and decision-making purposes. In Section 1 of the Exposure Draft, the IPSASB asserts that a measurement basis will contribute to meeting the information needs of users if it provides information that enables assessments of:~~

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- ~~(a) Financial capacity;~~
- ~~(b) Operational capacity; and~~
- ~~(c) The cost of services provided in the period.~~

AV6. It follows therefore that an appropriate measurement objective would be:

~~"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."~~

AV7. To operationalize this objective it is necessary to be clear about what is meant by financial capacity, operational capacity and cost of services.

AV8. Financial capacity is represented by the resources that an entity has available to meet financial claims on the entity, or that can be transformed into operating capacity. Operating capacity is represented by the resources that an entity has available to deliver services to meet the entity's service performance obligations. The cost of services is measured as the entity applies its operating capacity in the provision of services.

AV9. Some may argue it is not possible to make a distinction between operating and financial capacity, as both financial capacity and operating capacity is available to meet operational objectives. However, this member considers that because financial resources are only converted into operations when a transaction takes place, it is possible and useful to make this separation. Further, flows related to operating, investing and financing activities have been separately classified for some time (cf IPSAS 2, *Cash Flow Statements*) and therefore the related stocks can be separately identified. This member also notes that Government Finance Statistics (GFS) makes a similar distinction by determining net financial worth separately from net worth.

#### Measuring Financial Capacity

AV10. Measurement of financial capacity provides information to assess the extent of the resources an entity has available to meet financial claims or which can be transformed into operating capacity. It provides information about an entity's liquidity and solvency. The financial claims of others on the entity would have the impact of reducing the entity's financial capacity.

AV11. Assets that provide financial capacity (and financial liabilities that limit financial capacity) are usually acquired, issued, incurred or held with the expectation of generating returns (or costs) from interest, dividends and changes in market value. Given the purpose of holding such financial capacity assets and liabilities, the most useful information for users seeking to hold the entity to account for its management of financial capacity and seeking to make decisions relating to the entity's financial capacity is likely to be *current prices and exit-based prices*. If such prices are not practical of faithful representation, the most useful information for users is likely to be the most relevant substitute for those current exit based prices.

AV12. Of the two models proposed in Section 4 of the Exposure Draft, the fair value model is likely to best operationalize the measurement objective of fairly reflecting financial capacity. Using the fair value model in pursuit of the proposed measurement objective would ensure that financial capacity resources that are transformed into operational capacity reflect current measures and the inputs to services would most fairly reflect their current cost. It would also

CONCEPTUAL FRAMEWORK FOR GENERAL PURPOSE FINANCIAL REPORTING BY PUBLIC SECTOR ENTITIES:  
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~~provide the most relevant information on the capacity of the entity to meet the claims of creditors and lenders.~~

AV13. ~~In determining the most appropriate measurement requirements in a standard, the IPSASB would also need to consider the costs and risks of applying such measurement attributes against these benefits. In practice other measures may be used as good surrogates for the preferred measure where the preferred measure is not capable of being reliably determined. Practical difficulties associated with a measurement basis do not negate the value of having a measurement objective. Rather, a measurement objective would ensure that costs and risks associated with a measurement approach are assessed against the benefit of the information articulated by the measurement objective.~~

AV14. ~~Three common objections to the use of current exit based measures are complexity, volatility and lack of reliability or faithful representation. This alternative view comments briefly on each of these objections.~~

AV15. ~~In relation to complexity, application of current exit based measures to financial instruments would suggest that an effective interest rate approach to measurement is appropriate for interest bearing securities. Some have argued that requiring the use of effective interest rates is too complex (and unnecessarily expensive for preparers), compared to a simpler amortized approach. However, such complexity does not appear to impede the capital markets from carrying out such analyses, nor does it deter those markets from establishing prices for financial instruments generally.~~

AV16. ~~A second risk often noted about using current and exit based attributes to measure financial capacity assets and liabilities is the concern that they may conceal the financial results of operations by introducing unwarranted volatility in reporting. The impact of changes in current exit values (whether positive or negative) on an entity's financial capacity are, however, an important aspect of the entity's financial performance, and can be easily distinguished from operating performance or the cost of services in the statement of financial performance.~~

AV17. ~~In relation to lack of reliability, operationalizing the measurement objective as proposed allows for substitutes to be used when current, exit based prices are not practicable of faithful representation. However, the term "practicable of faithful representation" is intended to convey the idea that the application of a measurement basis to an asset or liability should result in a number that can be demonstrated to reasonably represent the financial capacity of the entity within a range of materiality. It does not simply mean that an asset or liability is faithfully represented simply because the measure faithfully represents the attributes of the measurement basis. The introduction of measurement objective, against which that a measurement approach can be tested for faithful representation, provides a protection against such sterile arguments.~~

#### **Measuring Operational Capacity and Cost of Services**

AV18. ~~Public sector entities operations cover a vast span of activities. Common to all these activities is the fact that an entity transforms inputs into outputs. Inputs include assets such as plant and equipment, and infrastructure assets. The financial capacity of the entity can also be regarded as an input, available to be transformed into operational capacity.~~

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- ~~AV19. In assessing the entity's operational capacity and cost of services, users are interested in such matters as the nature and extent of the physical and other resources available to support the provision of services in future periods, the capacity of the entity to adapt to changing circumstances, the actual cost of services provided in the period compared to expectations, whether current levels of taxes and other income are sufficient to maintain the volume and quality of services currently provided, and whether resources have been used economically and efficiently.~~
- ~~AV20. Application of the proposed measurement objective to operational capacity and cost of services would involve selecting the measurement attribute that most fairly reflects the cost of services and operational capacity of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes. The measurement basis selected should be the most informative against that criterion.~~
- ~~AV21. The approach that would be most consistent with the measurement objective being proposed would be to measure operational capacity assets and obligations (intended to be used as inputs to an entity's services) at current entry prices or, when such prices are not practical of faithful representation, on the basis of the most relevant substitute. Of the two models proposed in Section 4 of the Exposure Draft, the deprival value model is likely to best operationalize the measurement objective of fairly reflecting operating capacity. In using that model, if the entity would not replace the asset, then an exit approach would be adopted, effectively reclassifying the resource from operating capacity to financial capacity. For financial capacity assets being deployed in operations, the exit price from the entity's financial capacity becomes the entry price to the entity's operating capacity.~~
- ~~AV22. Using current entry prices for assets and liabilities that form the entity's operating capacity, as would generally occur under the deprival value model, is consistent with both the proposed measurement objective and therefore with the purpose of financial reporting. The use of current measures provides relevant and comparative information on the cost of services. The use of entry prices avoids the risk of anticipating value that is yet to be achieved by an entity's operations in transforming inputs into outputs that would be entailed in a fair value approach. The use of current entry prices also avoids the risk that changing market prices (exit prices) that do not impact on an entity's entry prices and therefore its operating capacity are used to remeasure that capacity or the entity's cost of services.~~
- ~~AV23. As in determining measurement bases for financial capacity assets and liabilities within a standard, the IPSASB would also need to consider the costs and risks of applying these measurement attributes against the benefits described above. In practice other measures may be used as good surrogates for the preferred measure. For example, in a low inflation environment the actual cost of recently acquired inputs could be the most appropriate cost-effective measurement methodology beyond initial measurement for most inputs under this approach. As before, this does not negate the value of having a measurement objective to ensure that the costs and risks are assessed against the benefits of the information.~~
- ~~AV24. A common objection to the deprival value model is the implied complexity it entails in requiring comparisons against different measurement bases. However, in most cases a current, entry-based measure or a proxy for the entry-based measure should be available (in the absence of indicators of impairment). It is generally accepted that only when indicators of~~

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~~impairment are present do comparisons between different measurement bases become necessary to meet the objectives of financial reporting.~~

**Conclusion**

~~AV25. This member proposes that the Conceptual Framework should incorporate a measurement objective, and that the measurement objective should be: "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". The two measurement models discussed in the Framework would be the main approaches used in pursuing such an objective. In accordance with this measurement objective, financial capacity would be best reflected by a fair value model (an exit-based model), whereas operating capacity and cost of services would be best reflected by a deprival value model (usually an entry-based model).~~

~~AV26. Detailed application requirements are then able to be consistently and coherently developed in standards. In determining the most appropriate measurement base or model within a standard, the IPSASB would need to consider the costs and risks of applying such measurement attributes prescribed in the models against the benefit expressed in terms of achieving the proposed measurement objective. When the preferred measure is not practicable of faithful representation then the most relevant substitute that is practicable faithful of representation would be specified.~~

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**Appendix 1A**

**The IASB Conceptual Framework (September 2010)**

**Measurement of the Elements of Financial Statements**

The International Accounting Standards Board (IASB) develops and publishes International Financial Reporting Standards (IFRSs). IFRSs are designed to apply to the general purpose financial statements and other financial reporting of all profit-oriented entities.

The IASB Conceptual Framework (issued in 1989 and updated in part in September 2010<sup>13</sup>) identifies the following measurement bases:

- Historical cost;
- Current cost;
- Realisable (settlement) value; and
- Present value.

It notes that the measurement basis most commonly adopted is historical cost, which is usually combined with other measurement bases.

<sup>13</sup> The IASB has recently reactivated its Conceptual Framework project. Measurement is under consideration as part of that project.



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**Appendix 1B**

**Statistical Reporting Guidelines of the 1993 System of National Accounts (updated 2008) and Other Guidance derived from it (ESA 95 and GFSM 2001)**

**Measurement of the Elements of Financial Statements**

The System of National Accounts (SNA), the international guidelines for national accounts, contains both general and specific guidance on valuation of assets and liabilities, which are then carried over into the European System of Accounts (ESA) and Government Finance Statistics Manual (GFSM).

The GFSM 2001 includes general guidance on the valuation of assets and liabilities as follows:

- The value of an asset is its current market value which is the amount that would have to be paid to acquire the asset on the valuation date, taking into account its age, condition, and other relevant factors. This amount depends on the economic benefits that the owner of the asset can derive by holding or using it.
- For nonfinancial assets the current market value includes all transport and installation charges and all costs of ownership transfer.
- The ideal source of price observations to obtain a current market value is a market in which the identical assets are traded in considerable volume and their market prices are listed at regular intervals. If there are no observable prices then a price or value has to be estimated. Possible methods of estimating current market prices include:
  - Written-down replacement cost—this value is the original acquisition value of the asset adjusted by an allowance for price changes and then written down for the accumulated consumption of fixed capital.
  - Securities that are not traded—this value can be estimated by reference to similar securities that are traded on a stock exchange by analogy, making an allowance for the inferior marketability of the non-traded securities.
  - Appraisals of tangible assets for insurance or other purposes—this value is generally based on observed prices for items that are close substitutes.
- The valuation of liabilities is the same as the valuation of the corresponding financial assets.

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Board*

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



International Public  
Sector Accounting  
Standards Board

This document was developed and approved by the International Public Sector Accounting Standards Board (IPSASB).

The IPSASB sets International Public Sector Accounting Standards (IPSASs) for use by public sector entities, including national, regional, and local governments, and related governmental agencies.

The objective of the IPSASB is to serve the public interest by setting high-quality public sector accounting standards and by facilitating the adoption and implementation of these, thereby enhancing the quality and consistency of practice throughout the world and strengthening transparency and accountability of public sector finances.

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# **THE CONCEPTUAL FRAMEWORK FOR GENERAL PURPOSE FINANCIAL REPORTING BY PUBLIC SECTOR ENTITIES**

## **Introduction**

The *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the Conceptual Framework) establishes and makes explicit the concepts that are to be applied in developing International Public Sector Accounting Standards (IPSASs) and Recommended Practice Guidelines (RPGs) applicable to the preparation and presentation of general purpose financial reports (GPFRs) of public sector entities.

IPSASs are developed to apply across countries and jurisdictions with different political systems, different forms of government and different institutional and administrative arrangements for the delivery of services to constituents. The International Public Sector Accounting Standards Board (IPSASB) recognizes the diversity of forms of government, social and cultural traditions, and service delivery mechanisms that exist in the many jurisdictions that may adopt IPSASs. In developing this Conceptual Framework, the IPSASB has attempted to respond to and embrace that diversity.

## **The Accrual Basis of Accounting**

The Conceptual Framework deals with concepts that apply to general purpose financial reporting (financial reporting) under the accrual basis of accounting.

Under the accrual basis of accounting, transactions and other events are recognized in financial statements when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognized in the financial statements of the periods to which they relate.

Financial statements prepared under the accrual basis of accounting inform users of those statements of past transactions involving the payment and receipt of cash during the reporting period, obligations to pay cash or sacrifice other resources of the entity in the future, the resources of the entity at the reporting date and changes in those obligations and resources during the reporting period. Therefore, they provide information about past transactions and other events that is more useful to users for accountability purposes and as input for decision-making than information provided by the cash basis or other bases of accounting or financial reporting.

## **The Conceptual Framework: Chapters**

The other chapters of the Conceptual Framework are:

- Preface
- Chapter 1: The Role and Authority of the Conceptual Framework
- Chapter 2: The Objectives of Financial Reporting
- Chapter 3: The Qualitative Characteristics
- Chapter 4: The Reporting Entity.
- Chapter 5: Elements and Recognition
- Chapter 7: Presentation

# CONCEPTUAL FRAMEWORK FOR GENERAL PURPOSE FINANCIAL REPORTING BY PUBLIC SECTOR ENTITIES: MEASUREMENT OF ASSETS AND LIABILITIES IN FINANCIAL STATEMENTS (TO BE UPDATED)

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## **1. Introduction**

- 1.1 Accounting standards specify the elements that are recognized in financial statements and how they are measured. This chapter identifies the measurement concepts that guide the IPSASB in the selection of measurement bases for International Public Sector Accounting Standards (IPSASs), and by preparers of general purpose financial statements (financial statements) in selecting measurement bases for assets and liabilities where there are no requirements in IPSASs. The chapter identifies the measurement bases that may be used in financial statements. It does not consider application of these bases to other general purpose financial reports (GPFRs) outside the financial statements.
- 1.2 Because the definitions of elements are linked, the amount at which assets and liabilities are measured will affect the amount of revenue, expenses and other elements recognized. Therefore the selection of a measurement basis is important not only for the statement of financial position, but also for the reporting of elements in other financial statements.

## 2. The Objective of Measurement

- 2.1 The objective of measurement is: *To select those measurement bases that most fairly reflect the financial capacity, operational capacity and cost of services of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes.*
- 2.2 The selection of a measurement basis contributes to meeting the information needs of users for accountability and decision-making purposes if it enables assessments of:
- (a) Financial capacity—the capacity of the entity to continue to fund its activities and meet its operational objectives in the future;
  - (b) Operational capacity—the physical and other resources available to support the provision of services in future periods; and
  - (c) The cost of services provided in the period in historical or current terms;
- 2.3 Chapter 3 identifies the qualitative characteristics (QCs) of information included in the GPFRs of public sector entities as: faithful representation; relevance; understandability; timeliness; comparability; and verifiability. The pervasive constraints on information included in GPFRs are materiality, cost-benefit, and achieving an appropriate balance between the QCs. In selecting a measurement basis the QCs and constraints are evaluated.

### Entry and Exit Values

- 2.4 Measurement bases may use either entry or exit values. For assets, entry values reflect the cost of purchase and exit values reflect the cost of sale. Historical cost is an entry value basis. An exit value also reflects the amount that will be derived from the asset from its use. In a diversified economy entry and exit prices differ as entities typically acquire assets from specialized suppliers and therefore incur transaction costs.
- 2.5 Measurement bases for liabilities may also be classified in terms of whether they are entry or exit values. Entry values relate to the transaction under which an obligation is received or the amount that an entity would accept to assume a liability. Exit values reflect the amount required to fulfill an obligation or the amount required to release the entity from an obligation.

### Observable and Unobservable Measures

- 2.6 Measures may be classified according to whether they are observable in an open, active and orderly market. Measures that are observable in an open, active and orderly market are likely to be more understandable and verifiable than measures that are not observable in such markets. They may also be more faithfully representative of the phenomena they are measuring.

### Entity-Specific and Non-Entity Specific Measures

- 2.7 Measures may also be classified according to whether they are “entity-specific” or “non-entity specific”. Measurement bases that are entity-specific reflect the economic and current policy constraints that affect the possible uses of an asset and the settlement of a liability by an entity. Entity-specific measures may reflect economic opportunities that are not available to other entities. Non-entity specific measures reflect general market opportunities rather than the economic and current policy constraints. The decision on whether to use an entity-specific or non-entity specific measures is taken by reference to the measurement objective and the qualitative characteristics (QCs).

### **Unit of account**

- 2.8 In order to provide information that best meets the measurement objective and QCs it may be necessary to aggregate assets and liabilities in the financial statements. An assessment of whether such an aggregation is appropriate also considers whether the benefits of a particular unit of account are commensurate with the costs of determining that unit of account.

### **Measurement Bases and their Selection**

- 2.9 It is not possible to select a single measurement basis for financial statements that will maximize the extent to which information meets the objectives of financial reporting and the QCs. The Framework does not prescribe a single measurement basis (or combination of bases). It provides guidance on the selection of a measurement basis for particular assets and liabilities in specific circumstances in order to meet the measurement objective.
- 2.10 The following measurement bases for assets are identified and discussed in terms of (a) the suitability of the basis (b) the information they provide about (i) the cost of services delivered by an entity, (ii) the operating capacity of an entity (iii) the financial capacity of an entity; and (c) the extent to which they provide information that meets the QCs :
- Historical cost
  - Market value
  - Replacement cost
  - Net selling price and
  - Value in use
- 2.11 The following measurement bases for liabilities are identified and discussed in terms of (a) the information they provide about (i) the cost of services delivered by an entity, (ii) the operating capacity of an entity (iii) the financial capacity of an entity; and (b) the extent to which they provide information that meets the QCs:
- Historical cost;
  - Market value;
  - Cost of release;
  - Assumption price; and
  - Cost of fulfillment.

### 3. Measurement Bases for Assets

#### Historical Cost

3.1 Historical cost for an asset is defined as:

“The amount of cash or cash equivalents paid or the market value of the other consideration given to acquire an asset at the time of its acquisition or construction”

3.2 Historical cost is an entry, entity-specific value. Under the historical cost basis<sup>1</sup>, assets are initially reported at the cost incurred on their acquisition, including transaction costs. Subsequent to initial recognition, this cost is allocated as an expense to reporting periods in the form of depreciation or amortization for certain assets, as the service potential and economic benefits embodied by such assets are consumed over their useful lives. Following initial recognition, the measurement of an asset is not changed to reflect changes in prices.

3.3 The amount of an asset may be reduced by recognizing impairments. Impairment is the extent to which the service potential or economic benefits provided by an asset have diminished due to changes in economic conditions, as distinct to their consumption. This involves assessments of recoverability. Conversely, the amount of an asset may be increased to reflect the cost of additions and enhancements or other events, such as the accrual of interest on a financial asset.

#### *Suitability of Historical Cost*

3.4 Under the historical cost basis, revenues are compared with expenses incurred in the reporting period, including the consumption of assets used in the provision of services; this comparison enables an assessment of the entity's capacity to recover depreciation through the generation of revenues. Where capital budgets are prepared on the cost basis, historical cost information demonstrates the extent to which transactions have been in accordance with those budgets and thereby meets the objective of accountability.

#### *Costs of Services*

3.5 Where the historical cost basis is used, the cost of services reflects the amount of the resources expended to acquire assets consumed in the provision of services. Historical cost generally provides a direct link to the transactions actually undertaken by the entity. However, because the costs used are those carried forward from an earlier period without adjustment for price changes, they do not reflect the cost of assets either at the reporting date or at the time at which the assets are consumed. As the cost of services is reported using past prices, information prepared on a historical cost basis will not facilitate the assessment of the likely future cost of providing services if price changes are significant. *Operating Capacity*

3.6 The historical cost basis provides information on the resources available to provide services in future periods, based on their acquisition cost. At the time an asset is purchased, it can be assumed that the value to the entity of its service potential is at least as great as the cost of purchase.<sup>2</sup> When depreciation or amortization is recognized it reflects the extent to which the service potential of an asset has been consumed. Historical cost information shows that the

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<sup>1</sup> The term “historical cost” may also be referred to as “cost” or generically as “cost-based measures.”

<sup>2</sup> Where this is not the case the initial historical cost measurement will be reduced by the amount of the impairment.

resources available for future services are at least as great as the amount at which they are stated. Increases in the value of an asset are not reflected under the historical cost basis. Therefore, on the basis of historical cost information, it is not possible to judge the extent to which the value of resources available to provide future services exceeds the recognized amount

#### *Financial Capacity*

- 3.7 The amount at which assets are stated in financial statements assists in an assessment of financial capacity. Historical cost can provide information on the amount of assets that may be used as effective security for borrowings. An assessment of financial capacity also requires information on the amount that could be received on sale of an asset, and reinvested in assets to provide different services. Historical cost does not provide this information when current exit values are significantly higher.

#### *Application of the Qualitative Characteristics*

- 3.8 Paragraphs 3.5–3.7 indicate the areas where historical cost provides relevant information in terms of its confirmatory or predictive value. Application of historical cost is often straightforward. Transaction information is usually readily available, and impairment is the exception rather than the rule. As a result amounts derived on a historical cost basis are generally representationally faithful in that they represent what they purport to represent—that is, the historical cost of the asset. Estimates of depreciation and impairment, particularly for non-cash-generating assets, can affect representational faithfulness. Because application of historical cost generally provides an indication of resources consumed by reference to actual transactions, historical cost measures are verifiable, understandable and can be prepared on a timely basis.
- 3.9 Historical cost information is comparable to the extent that prices at the time of acquisition are similar to those at the reporting date. Because historical cost does not reflect the impact of price changes, it is not possible to compare the amounts of assets that were acquired at different times when prices differed.
- 3.10 In certain circumstances the application of historical cost necessitates the use of allocations, for example, (a) where several assets are acquired in a single transaction, (b) where assets are constructed by the entity itself and overheads and other costs have to be attributed and, (c), the use of a flow assumption, such as first-in-first-out (“FIFO”) where many similar assets are held. To the extent such allocations are arbitrary they reduce the extent to which the resulting measurement fulfills the QCs.

## Current Value Measurement Bases

3.11 There are four current value measurement bases for assets:

- Market value;
- Replacement cost;
- Net selling price; and
- Value in use.

3.12 The following table summarizes the four measurement bases in terms of whether they use either entry or exit values, whether values are derived from observation of an open, active and orderly market and whether they are entity or non-entity specific.

Table 1: Summary of Current Value Measurement Bases

<b>Measurement Basis</b>	<b>Entry or Exit</b>	<b>Observable or Unobservable in a Market</b>	<b>Entity or Non-entity Specific<sup>3</sup></b>
Market value in open, active and orderly market	Entry and exit are the same	Observable	Non-entity specific
Market value in inactive market	Exit	Dependent on valuation technique	Non-entity specific
Replacement cost	Entry	Observable	Entity specific
Net selling price	Exit	Observable	Entity specific
Value in use	Exit	Unobservable	Entity specific

## Market Value

3.13 Market value for assets is defined as:

“The amount for which an asset could be exchanged between knowledgeable, willing parties in an arm’s length transaction.”

3.14 At acquisition market value and historical cost will be the same, if transaction costs are ignored. The extent to which market value meets the objectives of financial reporting and the information needs of users varies depending upon the relevance of market prices to the assessments being made on the quality of the market evidence. Market evidence, in turn, depends upon the characteristics of the market in which the asset is traded. Market value is particularly appropriate where it is judged that the difference between entry and exit values is unlikely to be significant or the asset is being held for sale.

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<sup>3</sup> In some cases a judgment has been made in classifying whether a particular measurement basis reflects an observable or unobservable market value and whether it is entity or non-entity specific.

*Market Values in Open, Active and Orderly Markets<sup>4</sup>*

3.15 Open, active and orderly markets have the following characteristics:

- There are no barriers that prevent those who wish to transact from doing so;
- They are active so there is a sufficient frequency and volume of transactions to provide price information; and
- They are orderly with many well-informed buyers and sellers so there is assurance of “fairness” in determining current prices.

An orderly market is one that is run in a reliable, secure, accurate and efficient manner. Such markets deal in assets that are identical and therefore mutually interchangeable, such as commodities, currencies and securities where prices are publicly available. In practice few, if any, markets fully exhibit all of these characteristics, but some may approach this description.

*Market Values where it cannot be Assumed that Markets are Open, Active and Orderly*

3.16 Markets for assets that are unique and rarely traded are not open, active and orderly: any purchases and sales are individually negotiated, and there may be a large range of prices at which a transaction might be agreed. Therefore participants will incur significant costs to purchase or to sell an asset. Market values therefore may reflect either an entry or exit perspective. In such circumstances it is necessary to use an estimation technique to estimate the price at which an orderly transaction to sell the asset would take place between market participants at the measurement date under current market conditions.

3.17 Estimation techniques include assumptions that:

- (a) For a non-financial asset, the valuation is based on the premise that the asset will be used in its highest and best use, taking into account physical characteristics and uses that are legally permissible and financially feasible;
- (b) The transaction takes place in the principal (or most advantageous) market for the asset; and
- (c) The most appropriate valuation technique(s) for measurement is used, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the asset.

3.18 Such estimation techniques have the explicit objective of producing an exit value: they estimate the price that would be received on sale of an asset. The relevant price is that prevailing in a transaction with another market participant. This means that the model relies on observable market evidence when available. The model may however also rely on unobservable inputs where observable market evidence is unavailable. Such estimation techniques may include conversion of future cash flows to a single current discounted amount.

*Suitability of Market Value*

3.19 In principle, market values provide useful information because they fairly reflect the value of the asset to the entity. In an open, active and orderly market, the asset cannot be worth less than

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<sup>4</sup> The term “open, active and orderly markets” was developed by Dr J. Alex Milburn. See *Toward a Measurement Framework for Profit-oriented Entities*, published by the Canadian Institute of Chartered Accountants in 2012.

market value (as the entity can obtain that amount by selling the asset), and cannot be worth more than market value, as the entity can obtain equivalent service potential or economic benefits by purchasing the same asset.

- 3.20 The usefulness of market values is more questionable when the assumption that markets are open, active and orderly is weakened. In such circumstances it cannot be assumed that the asset may be sold for the same price at which it can be acquired and it is necessary to estimate an exit-based market value. Exit-based market values are useful for assets that are held for trading, such as certain financial instruments, but may not be useful for specialized operational assets. Furthermore, while the purchase of an asset provides evidence that the value of the asset to the entity is at least as great as its purchase price, operational factors may mean that the value to the entity may be greater. Hence market values may not reflect the value to the entity of the asset, represented by its operating capacity.

#### *Costs of Services*

- 3.21 Revenue from services reported in financial statements is measured on the basis of prices current in the reporting period. If assets used to provide services are measured at market value, the allocation of the cost of assets to reflect their consumption in the current reporting period is based on the current market value of the asset.
- 3.22 The use of market values permits a return on assets to be determined. However, public sector activities are not generally carried out with the primary objective of generating profits, and services are often provided in non-exchange transactions or on subsidized terms, so there may be limited relevance in comparing the reported return to that implicit in exit-based market prices.
- 3.23 As noted above, revenue from services reported in financial statements is measured on the basis of prices current in the reporting period. Thus the surplus or deficit for a period reflects price movements that take place over the period during which assets and liabilities are held, and no profit or loss is reported on the sale of an asset. Where the asset is traded on an open, active and orderly market, the existence of the market provides assurance that the entity is able to realize the market value (and no more) at the reporting date: it is therefore unnecessary to postpone recognition of changes in value until a surplus is “realized” on sale. However, where assets used to provide services are not traded on open, active and orderly markets, or a close approximation, the relevance of revenue and expenses related to changes in market value is more questionable.

#### *Operating Capacity*

- 3.24 Information on the market value of assets held to provide services in future periods is useful if it reflects the value that the entity is capable of deriving from assets by using them in providing or delivering services. However, if exit-based market values are significantly lower than historical cost market value is likely to be less relevant than historical cost.

#### *Financial Capacity*

- 3.25 An assessment of financial capacity requires information on the amount that would be received on sale of an asset. This information is provided by market value except where estimated market values are entry-based.



### *Application of the Qualitative Characteristics*

- 3.26 Values determined in open, active and orderly markets can be readily used for financial reporting purposes. The information will meet the QCs: that is it will be relevant, representationally faithful, understandable, comparable and verifiable. Under such market conditions entry and exit values can be assumed to be the same or very similar. Because it can be prepared quickly, such information is also likely to be timely.
- 3.27 The extent to which market values meet the QCs will decrease as the quality of market evidence diminishes and the determination of such values relies on estimation techniques. As indicated above, exit-based market values are only likely to be relevant to assessments of financial capacity and not to assessments of the cost of services and operational capacity.

### **Replacement Cost**

- 3.28 Replacement cost<sup>5</sup> is defined as:

“The most economic cost required for the entity to replace the service potential of an asset (including the amount that the entity will receive from its disposal at the end of its useful life) at the reporting date.”

- 3.29 Replacement cost differs from market value because:

- (a) In a public sector context it is explicitly an entry value;
- (b) It includes all the costs, including transaction costs, that would necessarily be incurred in the replacement of the service potential of an asset; and
- (c) It is entity specific and therefore reflects the economic position of the entity, rather than the position prevailing on a hypothetical market. For example, the replacement cost of a vehicle is less for an entity that usually acquires a large number of vehicles in a single transaction and is regularly able to negotiate discounts than for an entity that purchases vehicles individually. Where the replacement cost of an asset for a public sector entity differs from that of a private sector entity, it is the price prevailing in the public sector that represents replacement cost.

- 3.30 Because entities usually acquire their assets by the most economic means available, replacement cost reflects the procurement or construction process that an entity generally follows. Replacement cost reflects the replacement of service potential in the normal course of operations, and not the costs that might be incurred if an urgent necessity arose as a result of some unforeseeable event (such as a fire).

- 3.31 Replacement cost is the cost of replacing an asset's service potential. Replacement cost adopts an optimized approach and differs from reproduction cost, which is the cost of acquiring an identical asset. <sup>6</sup>Although in many cases the most economic replacement of the service potential will be by purchasing an asset that is similar to that which is controlled, replacement cost is based on an

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<sup>5</sup> The full term is optimized depreciated replacement cost to denote that it refers to the replacement of the service potential embodied in an asset and not the asset itself. (see paragraph 3.32) The term “replacement cost” is used for economy of expression in the Framework.

<sup>6</sup> There may be cases where replacement cost equates to reproduction cost. This is where the most economic way of replacing service potential is to reproduce the asset.

alternative asset if that alternative would provide the same service potential more cheaply. For financial reporting purposes, it is therefore necessary to make adjustments to reflect the difference in service potential between the existing and replacement asset.

- 3.32 The appropriate service potential is that which the entity is capable of using or expects to use, having regard to the need to hold sufficient service capacity to deal with contingencies. Therefore the replacement cost of an asset reflects reductions in required service capacity. For example, if an entity owns a school that accommodates 500 pupils but, because of demographic changes since its construction, a school for 100 pupils would be adequate for current and reasonably foreseeable requirements, the replacement cost of the asset is that of a school for 100 pupils.

#### *Suitability of Replacement Cost*

- 3.33 Replacement cost is useful for both accountability and decision-making purposes. Because it is a current value, replacement cost reflects economic conditions prevailing at the reporting date. It is also entity-specific—it reflects the economic position of the entity since all (and only) the service potential that the asset embodies is reflected in its recognized amount, and does not vary according to the value—that the asset may have to another entity
- 3.34 In many cases the value, in terms of service potential that will be derived from an asset will be greater than its replacement cost. However, it would not be appropriate to report the asset at the value of that service potential, as they are future benefits rather than service potential at the reporting date. Replacement cost represents the highest potential value of an asset, as, by definition, the entity is able to secure equivalent service potential by incurring replacement cost.

#### *Costs of Services*

- 3.35 Replacement cost provides a relevant measure of the cost of the provision of services. The cost of consuming an asset is equivalent to the amount of the sacrifice incurred by that use. That amount is its replacement cost: the entity is able (if it is so desired) to restore its position to that prevailing immediately before the consumption of the asset by an outlay equal to replacement cost.
- 3.36 The costs of services are reported in current terms when based on replacement cost. Thus the amount of assets consumed is stated at their value at the time they are consumed (and not, as with historical cost, at the time they were acquired). This provides a valid basis for a comparison between the cost of services and the amount of taxes and other revenue received in the period (which are generally transactions of the current period and measured in current prices), and for assessing whether resources have been used economically and efficiently. It also provides a useful basis for comparison with other entities that report on the same basis, and for assessing the cost of providing services in the future and future resource needs, as future costs are more likely to resemble current costs than those incurred in the past, when prices were different.

#### *Operating Capacity*

- 3.37 As noted in paragraph 3.37, in principle, replacement cost provides a useful measure of the resources available to provide services in future periods, as it is focused on the current value of assets and their service potential to the entity.

#### *Financial Capacity*

- 3.38 As noted above, an assessment of financial capacity requires information on the amount that would be received on sale of an asset. Replacement cost does not provide this information. Thus where it

is used as a primary basis of financial reporting, it may usefully be supplemented by information on another basis, such as net selling price.

#### *Application of the Qualitative Characteristics*

- 3.39 As noted above, replacement cost is relevant to assessments of the cost of services and operational capacity. It is not relevant to assessments of financial capacity. In some cases calculation of replacement cost is complex, and subjective judgments are required. This may reduce the representational faithfulness of replacement cost. Replacement cost information may also not be straightforward to understand, particularly when that information reflects a reduction in required service potential as discussed in paragraph 3.32. Such cases also prejudice the timeliness, comparability and verifiability of information prepared on a replacement cost basis, and will also make it more costly than some alternatives.
- 3.40 Replacement cost information is comparable within an entity as assets that provide equivalent service potential are stated at similar amounts, regardless of when those assets were acquired. In principle different entities may report similar assets at different amounts, because replacement cost is an entity-specific measure that reflects the opportunities for replacement that are available to the entity. The opportunities for replacement may be the same or similar for different public sector entities. Where they are different, the economic advantage of an entity that is able to acquire assets more cheaply is reported in financial statements through lower asset values and a lower cost of services in order to be representationally faithful.

#### **Net Selling Price**

- 3.41 Net selling price is defined as:

“The amount that the entity can obtain from sale of the asset, after deducting the costs of sale.”

- 3.42 Net selling price differs from market value in that it does not require an open, active and orderly market or the estimation of a price in such a market. Net selling price therefore reflects constraints on sale. It is entity-specific.

#### *Suitability of Net Selling Price*

- 3.43 The potential usefulness of net selling price is that an asset cannot be worth less to the entity than the amount it could obtain on sale of the asset. However, it is not appropriate if the entity is able to use its resources more efficiently by employing the asset in another way, for example by using it in the delivery of services.
- 3.44 Net selling price is therefore useful where the most resource-efficient course available to the entity is to sell the asset. This is the case where the asset cannot provide service potential or economic benefits at least as valuable as net selling price. Net selling price may provide useful information where an entity is contractually obligated to sell an asset at below market value. There may be cases where net selling price can indicate a development opportunity.

#### *Costs of Services*

- 3.45 It is not appropriate to quantify the cost of the provision of services at net selling prices. Such an approach would imply that assets were written down to net selling price at the time of acquisition.

and that the expense reported when they were consumed in the provision of services would be based on that reduced amount.

#### *Operating Capacity*

- 3.46 Stating assets held for use in the provision of services at net selling price does not provide information useful to an assessment of operating capacity. Net selling price shows the amount that could be derived from an asset's sale, rather than the value of the service potential that could be derived from that asset.

#### *Financial Capacity*

- 3.47 As noted above, an assessment of financial capacity requires information on the amount that would be received on sale of an asset. Such information is provided by the use of net selling price. However, the lack of relevance of net selling price for assets that may yield more valuable service potential suggests that in such cases this information may be better presented as supplementary information rather than on the face of the statement of financial position.

#### *Application of the Qualitative Characteristics*

- 3.48 As indicated in paragraph 3.47 net selling price only provides relevant information where the most resource-efficient course available to the entity is to sell the asset. Assessments of net selling price are likely to be straightforward to obtain. For major assets it may be possible and cost-effective to obtain professional appraisals. Net selling price will generally provide understandable information. It is an entity-specific measurement basis and the extent to which it is likely to provide information that is comparable between entities is dependent on whether it is based on observable market values.
- 3.49 In most cases where net selling price is relevant, it will be adequately representationally faithful, verifiable and capable of being produced in timely manner.

#### **Value in Use**

- 3.50 Value in use is defined as:

“The present value to the entity of the asset's remaining service potential or economic benefits if it continues to be used, and of the net amount that the entity will receive from its disposal at the end of its useful life.”

#### *Suitability of Value in Use*

- 3.51 Value in use is an entity-specific exit value as it reflects the amount that can be derived from an asset through its operation and its disposal at the end of its useful life. As noted in paragraph 3.23 above, the value of an asset's service potential is often greater than its replacement cost. (It is also usually greater than its historical cost.) Where this is the case, reporting an asset at its value in use is of limited usefulness, as by definition, the entity is able to secure equivalent service potential at replacement cost.
- 3.52 Value in use is also not an appropriate measurement basis when net selling price is greater than value in use, as in this case the most resource-efficient use of the asset is to sell it, rather than continue to use it.

- 3.53 Therefore value in use is appropriate where it is less than replacement cost and greater than net selling price. This occurs where an asset is not worth replacing, but the value of its economic benefits or service potential is greater than its net selling price. In such circumstances value in use represents the value of the asset to the entity.
- 3.54 Value in use is an appropriate measurement basis for the assessment of impairments, because it is used in the determination of the recoverable amount for an asset or group of assets.

*Costs of Services, Operating Capacity, Financial Capacity*

- 3.55 Because of its complexity<sup>7</sup>, its limited applicability and the fact that its operationalization in a public sector context is likely to involve the use of replacement cost as an alternative, value in use is inappropriate for determining the cost of services. Its usefulness to assessments of operating capacity is limited and is only likely to be significant in the atypical circumstances where entities have a large number of assets that are not worth replacing, but the value of their service potential or economic benefits is greater than their net selling price. This may be the case if, for example, an entity will discontinue provision of a service in the future, but the proceeds of immediate sale are less than the service potential embodied in the assets. Value in use does involve an estimate of the net amount that an entity will receive from disposal of the asset. However, its limited applicability limits its suitability for assessments of financial capacity.

*Application of the Qualitative Characteristics*

- 3.56 The relevance of value in use is limited to assessments of impairment and the circumstances outlined in paragraph 3.58.
- 3.57 The extent to which value in use meets the other QCs depends on how it is determined. In some cases, an asset's value in use can be quantified by calculating the value that the entity will derive from the asset assuming its continued use. This may be based on the future cash inflows related to the asset, or on cost savings that will accrue to the entity through its control of the asset. The calculation of value in use takes into account the time value of money and, in principle, the risk of variations in the amount and timing of cash flows.
- 3.58 The calculation of value in use can be complex. Assets that are employed in cash-generating activities often provide cash flows jointly with other assets. In such cases value in use can be estimated only by calculating the present value of the cash flows of a group of assets and then making an allocation to individual assets.
- 3.59 In the public sector, most assets contribute to the provision of services in non-exchange transactions rather than to the generation of profits: such assets are referred to as "non-cash-generating assets." Because value in use is usually derived from expected cash flows, its operationalization in such a context can be difficult. It is inappropriate to calculate value in use on the basis of cash generated for such assets, so it is therefore necessary to use replacement cost as a proxy.
- 3.60 The method of determining value in use reduces its representational faithfulness. It also affects the timeliness, comparability, understandability and verifiability of information prepared on a value in use basis.

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<sup>7</sup> See below paragraph 3.58

## 4. Measurement Bases for Liabilities

- 4.1 This section provides the measurement bases for liabilities. This section does not repeat all the discussion in Section 3 on assets.
- 4.2 The measurement bases for liabilities, the corresponding terminology for liabilities and whether a basis is an entry or exit value is set out below.

Table 2: Measurement Bases for Liabilities and Corresponding Asset Terminology

Liabilities	Assets	Entry or Exit
Historical cost	Historical cost	Entry
Market value	Market value	Entry or exit
Cost of release	Net selling price	Exit
Assumption price	Replacement cost	Entry
Cost of fulfillment	Value in use	Exit

### Historical Cost

- 4.3 Historical cost for a liability is defined as:

“The amount cash or cash equivalents received, or the market value of the other consideration, in the transaction under which the obligation has been assumed”.

- 4.4 Where the time value of a liability is material (that is, where the length of time before settlement falls due is significant), the amount of the future payment is discounted so that, at the time a liability is first recognized, it represents the value of the amount received. The discount is amortized over the life of the liability, so that the liability is stated at the amount of the required payment when it falls due.
- 4.5 The advantages and drawbacks of using the historical cost basis for liabilities are similar to those that apply in relation to assets (see Section 3). However, historical cost cannot be applied for liabilities that do not arise from a transaction, such as a liability to pay damages for a tort or civil damages. It is also difficult to apply historical cost to liabilities that may vary in amount, such as those related to defined benefit pension liabilities.

### Market Value

- 4.6 Market value for liabilities is defined as:

“The amount for which a liability could be settled between knowledgeable, willing parties in an arm’s length transaction”

- 4.7 Conceptually, the advantages and disadvantages of a market value for liabilities are the same as those for assets. Such a measurement basis may be appropriate, for example, for liabilities under derivative financial contracts that are traded on organized exchanges. However, in cases where the ability to transfer a liability is restricted and the terms on which such a transfer might be made are unclear the case for market values is significantly weaker. This is particularly the case for liabilities

arising from obligations in non-exchange transactions, because it is unlikely that there will be an open, active and orderly market for such liabilities.

### **Cost of Release**

- 4.8 “Cost of release” is the term used in the context of liabilities to refer to the same concept as “net selling price” in the context of assets. Cost of release refers to the amount that relates to an immediate exit from the obligation. Cost of release is the amount that either (a) the creditor will accept in settlement of its claim, or (b) a third party would charge to accept the transfer of the liability from the obligor. Where there is more than one way of securing release from the liability, the cost of release is that of the lowest amount. (This is consistent with the approach for assets where net selling price would not reflect the amount that would be received on sale to a scrap dealer, if a higher price could be obtained from sale to a purchaser who would use the asset.)
- 4.9 For some liabilities, particularly in the public sector, transfer of a liability is not practically possible and cost of release will therefore be simply the amount that the creditor will accept in settlement of its claim. This amount will be known if it is specified in the agreement with the creditor (for example, where a contract includes a specific cancellation clause).
- 4.10 In some cases there may be evidence of the price at which a liability may be transferred (for example, in the case of some pension liabilities). Transferring a liability may be distinguished from entering into an agreement with another party that will fulfill the entity’s obligation or bear all the costs stemming from a liability. For a liability to be transferred it is necessary that all of the creditor’s rights against the entity are extinguished. If this is not the effect of an arrangement, the liability continues to exist and remains a liability of the entity.
- 4.11 In considering whether cost of release is appropriate it is necessary to consider whether release in the envisaged manner is an option that is open to the entity in practice, having regard to any consequences of obtaining release, such as damage to the entity’s reputation.
- 4.12 Just as net selling price is relevant only when the most resource-efficient course available to the entity is to sell the asset, so cost of release is relevant only when the most resource-efficient course is to seek immediate release from an obligation. In particular, where cost of fulfillment is lower than cost of release, cost of fulfillment will provide more relevant information than cost of release, even if cost of release is feasible.

### **Assumption Price**

- 4.13 Assumption price” is the term used in the context of liabilities to refer to the same concept as “replacement cost” in the context of assets. Just as replacement cost represents the amount that an entity would rationally pay to acquire an asset, so assumption price is the amount which the entity would rationally be willing to accept in exchange for assuming an existing liability. Exchange transactions carried out on arms-length terms will provide evidence of assumption price; this is not the case for non-exchange transactions.
- 4.14 In the context of an activity that is carried out with a view to profit, an entity will assume a liability only if the amount it is paid to assume the liability is greater than the cost of fulfillment or release (i.e., the settlement amount). Once that assumption price has been received by the entity, the entity has an obligation to its creditor.

- 4.15 Although typically the entity will expect to be able to fulfill its obligation and thereby extinguish its liability, it is an oversimplification to characterize the obligation as simply that of performing. The entity's obligation is either to perform or to compensate the other party for any loss that might arise from the entity's failure to perform. Compensation includes at least refunding any amounts paid. Thus stating the liability at assumption price provides a representationally faithful measure, reflecting the entity's accountability to its creditor for the amount that has been paid.
- 4.16 At the time a liability is first incurred, assumption price represents the amount that was accepted by the entity for assuming the liability: it is therefore usually reasonable to assume that assumption price is the price that the entity would rationally accept for assuming a similar liability. It would charge a higher amount, if competitive pressures allowed it to do so, but it might be unwilling to accept a lower price. Just as replacement cost is a current value so, conceptually, is assumption price. There are, however, practical problems in reflecting changes in prices in obligations that are stated at assumption price.
- 4.17 A consequence of stating performance obligations at the assumption price is that no surplus is reported at the time the obligation is taken on. A surplus or deficit is reported in the financial statements in the period when fulfillment (or release) takes place, as it is the difference between the revenue arising from satisfaction of the liability and the cost of settlement.
- 4.18 An entity may have a potential obligation that is larger than assumption price. If the entity has to seek release from a contract, the other party to the contract may be able to claim recompense for losses that it will sustain, as well as the return of any amounts paid. However, provided that the entity can settle the obligation by fulfillment, it can avoid such additional obligations and it is representationally faithful to report the obligation at no more than assumption price. (This is analogous to the position where an asset will yield greater benefits than replacement cost. Under such circumstances, as explained in Section 3, replacement cost rather than value in use is the most relevant measurement basis).

### **Cost of Fulfillment**

- 4.19 Cost of fulfillment is the current value of fulfilling the obligations represented by the liability. Where the obligation is financial, fulfillment will be making the required payments; where the obligation is to provide goods or services, fulfillment consists of providing those goods or services.
- 4.20 Cost of fulfillment includes all costs that the entity will incur in fulfilling the obligations represented by the liability, assuming that it does so in the least costly manner. The costs include not only payments to the counterparty but also other costs that will arise from fulfilling the obligation.
- 4.21 Where the cost of fulfillment depends on uncertain future events, all possible outcomes are reflected in the estimated cost of fulfillment, which should aim to reflect all those possible outcomes in an unbiased manner.
- 4.22 Where fulfillment requires work to be done—for example where the liability is to rectify environmental damage—the relevant costs are those that the entity will incur. This may be the cost of doing the work itself, or of employing a contractor to do the work on its behalf. However, the costs of employing a contractor are only relevant where employing a contractor is the least costly means of fulfilling the obligation.
- 4.23 The cost of fulfilling a liability is the value to the entity of resources that will be used in making fulfillment, and not necessarily their carrying amount at the reporting date.



- 4.24 Where fulfillment will be made by the entity itself, the fulfillment cost does not include any surplus, because any such surplus does not represent a use of the entity's resources. Where fulfillment amount is based on the cost of employing a contractor, the amount will implicitly include the profit required by the contractor, as the total amount charged by the contractor will be a demand on the entity's resources. (Similarly, for assets replacement cost would include the profit required by a supplier, but no profit would be included in the replacement cost for assets that the entity would replace through self construction).
- 4.25 Where fulfillment will not take place for an extended period, the flows need to be discounted to reflect the value of the liability at the reporting date.
- 4.26 Cost of fulfillment is generally relevant except in the following circumstances:
- (a) Where the entity can obtain release from an obligation at a lower amount than cost of fulfillment, then cost of release is a more relevant measure of the current burden of a liability. (Just as, for an asset, net selling price is more relevant when it is higher than value in use).
  - (b) In the case of liabilities assumed for a consideration, assumption price is more relevant when assumption price is higher than both cost of fulfillment and cost of release.

## Basis for Conclusions

*This Basis for Conclusions accompanies, but does not form part of, the Conceptual Framework.*

### Section 1: The Role of Measurement in the Framework

- BC1. When the IPSASB initiated Phase 3 of the Framework project, the IPSASB decided that the initial focus should be on measurement of the elements for the financial statements. The IPSASB acknowledges that there is a need to consider the measurement of other elements in the GPFRs outside the financial statements. However, in order to put future standard setting activities for the financial statements on a sound and transparent footing, the IPSASB decided to develop firstly measurement approaches for the financial statements, while acknowledging that elements for areas of financial reporting outside the financial statements will need to be developed in the future.

### Section 2: A Measurement Objective

- BC2. The IPSASB considered whether a specific measurement objective should be developed. The IPSASB initially took the view that a separate measurement objective was unnecessary, because a measurement objective might compete with, rather than complement, the objectives of financial reporting and the QCs specified in Phase 1 of the Framework<sup>8</sup>. Accordingly, Exposure Draft, *Elements and Recognition in Financial Statements* (CF–ED3) related the factors relevant to the selection of a measurement basis to the objectives of financial reporting and the QCs, but did not include a measurement objective.
- BC3. Consistent with this approach CF–ED3 envisaged that the Framework would not seek to identify a single measurement basis (or combination of bases) for all circumstances. The IPSASB acknowledged that requiring a single measurement basis to be used in all circumstances would clarify the relationship between different amounts reported in the financial statements: in particular, the amounts of different assets and liabilities could be aggregated to provide meaningful totals. However, the IPSASB took the view that there is no single measurement basis that will maximize the extent to which financial statements meet the objectives of financial reporting and fulfill the QCs.
- BC4. CF–ED3 included an Alternative View (AV), which proposed a measurement objective on the grounds that a Conceptual Framework that does not connect the objective of measurement with the objectives of financial reporting is incomplete and will limit the ability of the IPSASB to make consistent decisions about measurement across financial reporting standards and over time. Further, in the absence of a measurement objective, the AV considered that there is a risk that different and/or inappropriate measurement bases could be used to measure similar classes of assets and liabilities. The AV proposed the following measurement 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.”
- BC5. Many respondents, while generally in favor of the approach in CF–ED3, supported the AV. The IPSASB also acknowledged the view that the Framework’s approach to measurement should be

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<sup>8</sup> Subsequently Chapters 2 and 3.

aspirational and that the Framework should identify a single measurement basis underpinned by an ideal concept of capital<sup>9</sup>. The IPSASB accepted that the operating capability concept is relevant for public sector entities whose primary objective is the delivery of services. However, adoption of such a measurement objective involves a virtually explicit acknowledgement that current cost measures are superior to historical cost. For the reasons given below the IPSASB considers that historical cost measures often meet the measurement objective and therefore should be given appropriate emphasis in the Framework.

- BC6. The IPSASB was persuaded by the views of those who argue that a measurement objective is necessary in order to guide standard-level decisions on the selection of measurement bases. However, the IPSASB noted that assets and liabilities contribute to the financial performance and financial position of entities in different ways and that such an assessment should be based on the extent to which they contribute to financial capacity and operational capacity. The IPSASB concluded that linking a measurement basis to an ideal concept of capital might unduly restrict the choice of measurement bases. The IPSASB therefore rejected the view that adoption of measurement objective should be based on an ideal concept of capital and reaffirmed its view that a mixed measurement approach is appropriate in the public sector.
- BC7. The IPSASB therefore considered whether the measurement objective proposed in the AV was appropriate. Some argued that the proposed measurement objective was too aligned to current value measures. However the IPSASB formed a view that reference to “cost of services” provide a sufficient link to historical cost, because the cost of services can be determined using both historical cost and current value measures. The IPSASB therefore adopted the following measurement objective with only a minor modification from that proposed in the AV:

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

- BC8. The IPSASB also noted that the disadvantages of using different measurement bases may be minimized by:
- (a) Selecting different measurement bases only where this is justified by economic circumstances, thereby ensuring that assets and liabilities are reported on the same basis where circumstances are similar; and
  - (b) Requiring transparent presentation and disclosure to ensure that the measurement bases used and the amounts reported on each basis are clear.

### **Initial and Subsequent Measurement**

- BC9. A measurement basis needs to be selected both when an asset or liability is recognized for the first time (initial measurement) and when it is reported in the financial statements of a later period (subsequent measurement). Some accounting policies are expressed in a way that may suggest that different principles apply to initial and subsequent measurement. For example, an asset may initially be recognized at transaction price and subsequently at a current value. The IPSASB therefore considered whether the Framework should discuss initial and subsequent measurement separately.

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<sup>9</sup> Such concepts of capital include invested money capital, current cash equivalents and operating capability

- BC10 One reason why different measurement bases may be specified for initial and subsequent recognition is that the basis to be used for subsequent recognition is not available at the time of initial recognition. This is particularly common in the public sector where assets are sometimes contributed, or provided on subsidized terms, or in exchange for other non-cash assets. In such a case the value of the transaction may be unknown, and if the asset is to be subsequently accounted for at an entry value such as historical cost or replacement cost, another basis has to be specified for use on initial recognition as a surrogate for the amount at which the asset would be stated if purchased on arm's-length terms. Surrogates may also be required for the initial recognition of assets acquired before the introduction of accrual accounting where the transaction price is not known. The use of surrogates that meet the measurement objective and the QCs is an application of a measurement basis rather than a departure from it.
- BC11 Another reason for an apparent difference in initial and subsequent measurement arises where an asset is to be accounted for at a current value, and the transaction price is deemed to reflect the particular current measurement basis that will be used. In such a case, specifying that the asset is to be initially recognised at transaction price makes it clear that that application of the policy will not result in the recognition of revenue on initial recognition ("day one" gains or losses). In principle, the same measurement basis is used for both initial and subsequent recognition: the requirements for each are specified differently in order to assist understanding.
- BC12 The IPSASB concluded that, in principle, the same considerations apply to initial and subsequent measurement. Accordingly the discussion in this Chapter is applicable to both situations.

### Section 3: Measurement Bases for Assets

#### Historical Cost

- BC13 Historical cost is a widely applied measurement basis in the financial reporting of the public sector in many jurisdictions. Many respondents to the Consultation Paper, *Elements and Recognition in Financial Statements (CF-CP3)* and CF-ED3 supported the continued widespread use of historical cost as a measurement basis, mostly in combination with other measurement bases. They supported this view by reference to accountability objective and the understandability and verifiability of historical cost. They also noted that, because historical cost is widely adopted, its continued use avoids the costs that would arise if a revised standard were to require the use of a different measurement basis.
- BC14 The IPSASB agreed that historical cost is generally understandable and verifiable and that where it is used under current practice, a change to another measurement basis should be required only where it is judged that the benefits of doing so outweigh the costs of change.
- BC15 Some respondents considered that historical cost information provides a highly relevant basis for the reporting of the cost of services. Supporters of historical cost consider that the link between historical cost and the transactions actually undertaken by the entity is particularly important for an assessment of accountability; in particular, historical cost provides information that resource providers can use to assess the fairness of the taxes they have been assessed or have otherwise contributed in a reporting period, thereby enhancing accountability.
- BC16. The IPSASB agreed that, in many contexts, it is relevant to provide information on the transactions actually carried out by the entity, and accepted that users are interested in the cost of services based on actual transactions. Historical cost provides information on what services

actually cost in the reporting period, rather than what they will cost in the future; pricing decisions based on historical cost information may promote fairness to consumers of service.

- BC17. The IPSASB also acknowledged the views of those who consider that the use of historical cost facilitates a comparison of actual financial results and the approved budget. The IPSASB accepts that budgets may often be prepared on a historical cost basis and that where this is the case historical cost enhances comparison against budget. However, budgets may also reflect anticipated prices during a reporting period.
- BC18. The IPSASB also acknowledged a contrary view: that assessing and reporting the cost of providing services in terms of the value that has been sacrificed in order to provide those services provides useful information for both decision making and accountability purposes. Because historical cost does not reflect the value of assets at the time they are consumed, it does not provide information on that value in circumstances where the effect of price changes is significant. The IPSASB concluded that it is important that the Framework responds to both these contrasting perspectives.

### **Market Value and Fair Value**

- BC19. CF–ED3 did not propose fair value as a measurement basis. Rather it proposed market value, which was defined in the same way as fair value in the IPSASB’s literature at the time the Conceptual Framework was developed. A number of respondents challenged the failure to propose fair value as a measurement basis and to define fair value. They pointed out that fair value is a measurement basis that is defined and used in specifying measurement requirements by many global and national standard setters and that a definition of fair value based on the IASB’s pre-IFRS 13 definition of fair value had been used extensively in IPSASB’s literature. They further highlighted the definition of fair value in IFRS 13, *Fair Value Measurement*, issued in May 2011. Such respondents considered that the IPSASB’s Conceptual Framework should include fair value as a potential measurement basis and that the definition should mirror that in IFRS 13.<sup>10</sup>
- BC20. The IPSASB’s rationale for the approach proposed in CF–ED3 was that fair value is very similar to market value and the inclusion of both measurement bases is likely to be confusing to the users of financial statements. The IPSASB also noted that fair value, as defined in IFRS 13 is explicitly an exit value. Therefore the relevance of fair value in the public sector is likely to be primarily limited to providing information on financial capacity, rather than on providing information on the cost of services and operating capacity. In addition, replacement cost (referred to as the cost approach in IFRS 13) is used as a valuation technique in IFRS 13 to estimate fair value. In the context of IFRS 13 replacement cost is used as a surrogate to determine an exit value. In this chapter replacement cost is proposed as an entity-specific, entry-value measurement basis in its own right.
- BC21. In the public sector many assets are specialized and differences in entry and exit prices are therefore significant. Where an asset will provide service potential or other economic benefits that are greater than its exit price, a measure reflecting exit values is not the most relevant basis. Where the most resource efficient course is to sell the asset (because the service potential or economic benefits that it will provide is not as great as can be received from sale, the most

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<sup>10</sup> The definition in IFRS 13 was used as the definition of fair value in the IASB’s Discussion Paper, which characterized fair value as “the most frequently used current value measurement.”

relevant measurement basis is likely to be net selling price, which reflects the costs of sale and, although likely to be based on market evidence, does not assume the existence of an active, open and orderly market).

- BC22. In considering the merits of fair value (as used in IFRS 13) as a measurement basis, the IPSASB accepted that fair value provides a relevant basis for assessing a financial return. Where assets are stated at fair value, financial performance can be assessed in the context of the return implicit in market values. However, public sector activities are not generally carried out with a view to obtaining a financial return, so the relevance of assessing any such return in the context of a market setting is limited.
- BC23. In finalizing the measurement chapter the IPSASB considered three main options in dealing with this issue:
- (i) Adopt the IFRS definition of fair value;
  - (ii) Retain its current definition of fair value; or
  - (iii) Remove fair value as a measurement basis altogether as proposed in CF–ED3.
- BC24. Adopting the IFRS definition would have meant using a definition of fair value that is not well aligned with the objectives of most public sector entities – the delivery of services rather than the generation of cash flows. It is questionable whether measures based on the current IFRS definition would provide relevant information for many assets held for their operational capacity and for liabilities arising from non-exchange transactions where it is not feasible to transfer the liability. However, the IPSASB acknowledged that adopting the IASB definition of fair value would make the maintenance of alignment with IFRS more straightforward in the future.
- BC25. Retaining the IPSASB's current definition of fair value or a slightly modified version of the current definition in the IPSASB literature would have meant that two global standard setters would have different definitions of the same term.
- BC26. The non-inclusion of fair value would have implications for the IPSASB's extant literature at the time the Framework was finalized, because a number of IPSAS's contained fair value in measurement requirements or options.
- BC27. The IPSASB acknowledged that its approach to fair value at a standards level had not kept pace with global developments since its definition of fair value had been first adopted and recognized that all the above options have disadvantages. On balance the he IPSASB concluded that, rather than include an exit-based definition of fair value, or a public sector specific definition that differs from that in IFRS 13 should not be proposed as a measurement basis. Therefore the IPSASB decided to include market value as a measurement basis in the Framework.

### **Replacement Cost, Net Selling Price and Value in Use**

- BC28. As discussed in *the Preface to the Conceptual Framework* the objective of public sector entities is to deliver goods and services, often in non-exchange transactions, rather than to generate profits. Therefore many non-financial assets are held for operational purposes. Furthermore, many of these assets are specialized and unlikely to be purchased or sold in open, active and orderly markets. Market value facilitates an assessment of financial capacity and operational capacity where operational assets are not specialized and traded in open, active and orderly markets. However, current measurement bases other than market value are necessary in order to provide

useful information on the cost of services and operational capacity where assets are specialized and where market-based information is limited.

- BC29. In evaluating measurement bases that provide the most useful information for specialized operational assets the IPSASB sought a basis that reflects the continuing provision of goods and services by public sector entities. The most appropriate basis for such assets is one that provides information on the cost of future service potential that is attributable to an asset.
- BC30. The IPSASB considered reproduction cost as a potential measurement basis. Reproduction cost is easily understandable. However, it reflects the cost of obtaining an identical asset, rather than the cost of replacing the service potential provided by an asset. Therefore reproduction cost may reflect features of assets that no longer serve any economic purpose and its use may exaggerate the value of an asset. Replacement cost avoids this risk because it is based on the most economic cost required for the entity to replace the service potential of an asset. While accepting that the calculation of replacement cost may in some cases be complex and involve subjective judgments the IPSASB concluded that replacement cost is the measurement basis that often best meets the measurement objective and the QCs.
- BC31. The IPSASB acknowledged that replacement cost will not always be an appropriate measurement basis for specialized operational assets. There may be circumstances where an entity no longer intends to continue to operate an asset. In such circumstances replacement cost is not a useful measurement basis, because it would not be rational for the entity to replace the service potential provided by an asset. The IPSASB therefore considered the appropriate measurement basis for such circumstances. It considered fair value less costs to sell, noting that such a measurement basis aims to reflect conditions in an open, active and orderly market. However the IPSASB concluded that an entity specific measurement basis that reflects the constraints on sale for an entity is more appropriate. The IPSASB concluded that net selling price is the most appropriate basis. Net selling price is therefore included as a measurement basis in section 3 of this chapter. Net selling price can be distinguished from market value because net selling price does not assume an open, active and orderly market. Net selling price also provides information that meets the measurement objective, where an entity is contractually required, or in a binding arrangement, to sell an asset at below market value, perhaps in order to meet a social or political objective.
- BC32. In order to provide a complete analysis of the circumstances under which public sector entities operate the IPSASB also considered the situation where it would not be rational for an entity to seek to replace the service potential embodied in an asset, but it is still more rational for the entity to continue to operate the asset than to sell it immediately. The IPSASB therefore concluded that value in use should be included as a potential measurement basis. The IPSASB acknowledged that this measurement basis is not straightforward to operationalize in a non-cash-generating public sector context, and that it might therefore be necessary to use replacement cost as a surrogate.

## Fair Value Model

**BC33. While CF–ED3 did not propose fair value as a measurement basis in its own right it proposed the fair value measurement model as a method of determining market value where it has been decided that market value is the appropriate measurement basis, but the market is inactive or otherwise not open or orderly. Deprival Value Model**

BC34. CF-CP3 discussed the deprival value model as providing a rationale by which a specific current value basis may be selected as the most relevant in specified circumstances. Some respondents expressed reservations about the use of the deprival value model that was discussed in CF–CP3; in particular that it would be costly and impose a disproportionate burden on preparers to have to consider three possible measurement bases for each asset that is reported. A number of respondents also considered that it is over complex. The IPSASB also accepted a view that the deprival value model unduly exaggerates the QC of relevance and neglects the other QCs.

BC35. The IPSASB acknowledged such reservations while recognizing the deprival value model has been adopted successfully in some jurisdictions, the IPSASB included the deprival value model in CF–ED3 as an optional method of choosing between replacement cost, net selling price and value in use where the appropriate measurement basis could not be identified by reference to the objectives of financial reporting and the QCs

BC36. While a minority of respondents are highly supportive of the deprival value model many respondents to CF–ED3 continued to express reservations about the complexity of the deprival value model. The IPSASSB also acknowledged a technical ambiguity in the deprival value model that if net selling price is higher than replacement cost a development opportunity might be indicated and that users should be provided with this information, which the deprival value model would not do. Due to these factors the IPSASB decided not to include the deprival value model in the Framework, while retaining some of the insights provided by the model in its analysis of replacement cost, net selling price and value in use; for example, that it is inappropriate to measure an asset at replacement cost if either net selling price or value in use is lower.

## Symbolic Values

BC37. In some jurisdictions certain assets, often heritage assets, are recognized on the statement of financial position at symbolic or nominal values, typically one unit of the presentation currency. This treatment is adopted in order to recognize assets on the statement of financial position in circumstances where it is difficult to obtain a valuation or where an accounting policy has been adopted that such items should not be valued.

BC38. The accounting treatment for heritage assets is a standards level issue. However, the IPSASB took the view that symbolic or nominal approaches do not meet the measurement objective, because they do not provide information on financial capacity, operational capacity or the cost of services. In addition they do not meet the QCs of faithful representation and relevance. The decision whether to recognize an item as an asset should be made following an assessment of whether the item meets the asset definition and recognition criteria in Chapter 5.

## Section 4: Measurement Bases for Liabilities

BC39. The IPSASB concluded that the principles of measurement that apply to assets are equally applicable to liabilities. The discussion in Section 4 adapts the terminology and seeks to explain



the necessary differences of emphasis. The IPSASB acknowledged the views of those who noted that, because, as highlighted in *the Preface to the Conceptual Framework*, many goods and services are provided by public sector entities in non-exchange transactions there will often not be an assumption price. Furthermore, there is unlikely to be a cost of release, because the creditor is unlikely to accept a sum lower than cost of fulfillment in settlement; and instances where a third party would accept the transfer of such a liability from the obligor for a specified amount are likely to be rare. Therefore liabilities arising from non-exchange transactions are likely to be measured at the cost of fulfillment, and this will often be the only practical and relevant measurement basis. Nevertheless the IPSASB decided to retain the cost of assumption and the cost of release as there may be limited circumstances where these measurement bases meet the measurement objective.

#### **Other Issues**

BC40. CF–CP3 sought the views of respondents on the following two issues related to measurement:

- (a) The treatment of an entity's own credit risk and changes in value attributable to changes in an entity's own credit risk; and
- (b) Whether the measurement of an asset should reflect only the service potential relating to its existing use, or whether the measurement of an asset should include the incremental value relating to its possible alternative use.

BC41. The majority of respondents who provided comments on these issues considered that they were more appropriately dealt with at the standards level than within the Framework. The IPSASB concurred with this view, and these issues are accordingly not addressed in the Framework. The IPSASB noted that where a market value is used to measure a liability it is necessary to consider the treatment of the entity's own credit risk.

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**4B Conceptual Framework Measurement**

The IPSASB considered an Issues Paper that provided a further analysis of the responses to Conceptual Framework Exposure Draft (CF–ED3), *Measurement of Assets and Liabilities in Financial Statements*, and identified a number of issues on which Staff sought directions in order to develop a first draft of a final chapter on Measurement.

Staff noted that 39 responses had been received to CF–ED3. 37 of these responses had been reflected in the agenda materials for the June 2013 meeting. The Issues Paper and revised Collation and Summary at Agenda Item 4B.2 included Responses 038 and 039. Apart from the addition of comments from Respondents 038 and 039 only minor revisions had been made to the Collation and Summary from the version presented at the June meeting.

*Views of Respondents 038 and 039*

Staff had summarized the views of Respondents 038 and 039. In the view of Staff these responses raised a number of important issues from different perspectives.

Staff pointed out that Respondent 038 considered the discussion of historical cost unbalanced and felt that it favored replacement cost as the measurement basis for determining the cost of services. Staff noted that Respondent 039 had taken the converse view that CF–ED3 was too supportive of historical cost. Respondent 038 had expressed a view that CF–ED3 was insufficiently clear about one of the main advantages of historical cost; that this measurement basis provides information that resource providers can use to assess the fairness of the taxes they have been assessed or the rates they have been charged, thereby enhancing accountability.

Staff acknowledged this view and proposed to incorporate some of it in the Basis for Conclusions. The Chair noted that some constituents strongly reported historical cost and said that, in some jurisdictions, historical cost was considered the only appropriate measurement basis. One member expressed uncertainty about what would be added to the text and had some reservations whether Respondent 038 had considered the alternatives fully. In the view of this member it might be appropriate to discuss the view of Respondent 038 in the Basis for Conclusions, but not in the main text. Staff agreed that any such discussion should be limited to the Basis for Conclusions.

Staff highlighted that Respondent 039 had exhorted the IPSASB to adopt an aspirational approach and had advocated that a measurement objective should be underpinned by a single preferred concept of capital. These points were to be considered in more detail later in the session.

Members agreed that Staff had summarized the views of Respondents 038 and 039 adequately.

*Measurement Objective*

Staff noted that CF–ED3 had not proposed a specific measurement objective. It proposed that the selection of a measurement basis should be based on the extent to which a particular measurement basis meets the objectives of financial reporting: the provision of information for accountability and decision-making purposes. Although this proposal was uncontroversial and received full or partial support from a large majority of respondents expressing a view, a number of those who had partially supported the approach considered that it should be supplemented by a measurement objective. A minority of respondents had opposed the approach. Reasons for opposing the approach included a strong preference for historical cost and a need for the approach to emphasize prudence. Staff said that the

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issue of prudence had been addressed in Phase 1 and did not think that it should be reopened. Members agreed with this view.

The direction at the June 2013 meeting had been to develop a measurement objective based on the Alternative View (AV) in CF–ED3. Staff said that respondent 039 had argued in favor of an aspirational measurement objective based on an ideal measurement model, supported by an explicit concept of capital and had reminded the IPSASB of its 2011 submission to the Consultation Paper, *Measurement of Assets and Liabilities in Financial Statements*. This response identified and explained three concepts of capital:

- Invested money capital
- Current cash equivalents
- Operating capability

Staff expressed a view that neither the invested money capital nor current cash equivalents concepts of capital are appropriate for entities, which have a primary objective of delivering services rather than generating cash flows. Staff considered that the operating capability concept is highly relevant for public sector entities whose primary objective is the delivery of services. However, in the view of Staff, adoption of such a measurement objective involved a virtually explicit acknowledgement that current cost measures are superior to historical cost. Staff had therefore concluded that it would not be feasible to espouse the operating capability concept of capital in the final Measurement chapter unless the IPSASB were to reverse its view of historical cost.

There was general reluctance to make an explicit statement relating to concepts of capital and capital maintenance. It was noted that Respondents 038 and 039 expressed starkly opposing views on this issue. It was also considered that assets and liabilities have an impact on the financial performance and financial position of an entity in different ways. The IPSASB therefore decided that the measurement objective should not be based on an ideal concept of capital.

It was noted that at the June meeting Staff and the TBG had been directed to develop a measurement objective that was based on the objective in the AV and that the objective should include references to the QCs and constraints. Staff restated reservations that the objective was too aligned to current value measurement bases, while acknowledging that the inclusion in the AV objective of a reference to “cost of services” could provide a link to historical cost. The TBG had taken the view that the measurement objective in the AV is appropriate and that references to the QCs and constraints in financial reporting should be in supporting narrative.

The IPSASB did not agree that the AV objective is over-oriented to current measurement bases. Some views were expressed that the QCs should be incorporated into the objective and that the objective should be subsidiary to the QCs. However, the IPSASB directed that the QCs should not be incorporated into the objective, but should be addressed in supporting narrative. A minor wording change was agreed that “attributes” should be changed to “bases”. The revised wording to be included in the draft final chapter is therefore: *To select those measurement bases that most fairly reflect the financial capacity, operational capacity and cost of services of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes.*

### *Current Value Measurement Bases*

Staff noted that CF–ED3 proposed four current value measurement bases for assets: market value, replacement cost, net selling price and value in use. Staff expressed the view that the most controversial aspects of the approach to current value measurement bases were that:

- (i) Fair value was not included in the proposed measurement bases;
- (ii) Replacement cost was proposed as a measurement basis in its own right rather than as a valuation technique for estimating fair value; and whether
- (iii) Net selling price should be retained in the final chapter.

Staff explained that the rationale for not proposing fair value as a measurement basis was that:

- (i) Market value and fair value are largely synonymous, and that to propose both as measurement bases would therefore be confusing for users; and
- (ii) The IASB at standards level in IFRS 13 defines fair value explicitly as 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.*

It was further noted that the IASB Conceptual Framework DP described fair value as “the most frequently used current value measurement” and cites the IFRS 13 definition of fair value. This definition differs from the definition of fair value in the IPSASB’s current literature, which is based on the IASB’s pre-IFRS 13 definition of fair value. While a minority of respondents disagreed strongly, Staff questioned whether the application of an exit value is appropriate for assets that are primarily held for their operational capacity and where there is no current intention to realize the asset. Prescribing measurements based on exit values in such circumstances therefore, arguably, does not meet the QC of relevance.

In the view of Staff there were three main options in dealing with this issue:

- (i) Adopt the IFRS definition of fair value;
- (ii) Retain its current definition of fair value; or
- (iii) Remove fair value as a measurement basis altogether as proposed in CF–ED3.

Staff summarized the implications of each of these options. Adopting the IFRS definition would mean using a definition of fair value that is not well aligned with the objectives of most public sector entities – the delivery of services rather than the generation of cash flows. It was therefore questionable whether measures based on the current IFRS definition would provide relevant information for many assets held for their operational capacity and for liabilities arising from non-exchange transactions where it is not feasible to transfer the liability. However, adopting the IASB definition of fair value would make the maintenance of convergence with IFRS more straightforward in the future.

Retaining the current definition or a slightly modified version of the current definition in the IPSASB literature would mean that two global standard setters would have different definitions of the same term.

Defining market value rather than fair value has implications for the IPSASB’s current literature, which uses fair value widely. IPSAS 12, *Inventories*, IPSAS 16, *Investment Property*, IPSAS 17, *Property, Plant and Equipment*, IPSAS 27, *Agriculture*, and IPSAS 29, *Financial Instruments: Recognition and Measurement*, all contain measurement requirements that apply fair value.

One member asked for clarification of the measurement approach in the Government Finance Statistics Manual (GFSM). Staff said that IPSASB’s approach at standards level had been to align with IFRS rather than government finance statistics (GFS). Staff’s understanding was that GFS took a current value

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approach The Observer from the Government Finance Division of the IMF informed members that the GFSM used a current market value approach with estimations where a market value is not observable. One member suggested that adoption of option (i) might involve divergence from GFS.

Members noted that the definition of fair value had developed over recent years and that the IPSASB definition had not developed to reflect these changes. Therefore whatever option was selected there is a need to examine and update the use of fair value in the IPSASB's literature and to ensure that fair value is used consistently

It was pointed out that the proposed definition of market value is virtually the same as the current definition of fair value and that the staff proposal was therefore a rebranding exercise.

It was also suggested that because of the different overall objectives of financial reporting and different measurement objectives of the IPSASB and the IASB it was logical that measurement concepts would differ. There was general support for option (iii) and Staff was directed to draft the final chapter on this basis. Staff also proposed that market value should be defined separately for both assets and liabilities. This was accepted.

Staff summarized the main criticisms of replacement cost made by some respondents to CF-ED3, mainly that it was over-complex; subjective, because it is entity-specific; that the difficulties of obtaining market-based evidence had been exaggerated and that replacement cost as proposed in CF-ED3 was not based on a "highest and best" valuation principle.

The complexity and entity-specific nature of replacement cost was acknowledged. Nevertheless Staff considered that these factors needed to be balanced against the contention that replacement cost often provided the most relevant information. Staff suggested that CF-ED3 had perhaps exaggerated the difficulty of obtaining robust and observable market-based evidence and could be read as advocating replacement cost for all operational assets. Staff considered that market value could be used for many non-specialized operational assets where markets were generally open, active, and orderly and that this should be reflected in the final chapter. Staff also proposed that it should be clarified that the phrase "optimized depreciated replacement cost" should be used on first reference to replacement cost to indicate that replacement cost, as used in the Framework, is based on assessments of the service potential that an asset provides rather than the asset itself. The IPSASB directed that replacement cost should be retained in the final chapter.

Some respondents had questioned whether net selling price is an entity-specific measure and also whether it differs from market or fair value. Staff acknowledged that net selling price reflects market-based evidence, but expressed a view that it reflects an immediate exit and does not assume an open, active and orderly market; therefore it is appropriate to describe it as entity-specific. It was also pointed out that net selling price could reflect a contractual price that may not be market value.

One member asked whether net selling price might be negative under the proposed definition Staff was directed to retain net selling price but to carry out further analysis on whether net selling price could be negative. It was agreed that net selling price would be retained as a measurement basis.

It was also agreed that value in use would be retained as a measurement basis in the final chapter.

#### *Fair Value Measurement Model*

Staff sought confirmation of the tentative decision at the June meeting to delete the fair value measurement model from the draft final chapter while relocating some of the material into the discussion

of market value. The IPSASB reaffirmed that the fair value model should not be included in the draft final chapter.

#### *Deprival Value Model*

Staff sought confirmation of the tentative decision at the June meeting that the deprival value model should not be included in the final chapter. There was general support for omitting the deprival value model. Staff was asked what aspects of the model might be relocated to Section 3. Staff said that the relationship between net selling price and value in use could be incorporated in Section 3. One member commented that while he was content for the section on deprival value to be deleted he wanted the rationale for not including the deprival value model to be included in the final chapter. This approach was accepted.

#### *Liabilities*

Staff pointed out that CF–ED3 had proposed five measurement bases for liabilities: historical cost, market value, cost of release, assumption price and cost of fulfillment. Staff highlighted that some respondents had questioned whether cost of assumption and cost of release should be retained as they were unlikely to be feasible in many public sector circumstances. Another respondent questioned whether cost of release differed from market value. Staff expressed a view that cost of release differs from market value because it refers to an immediate exit from the obligation and therefore that it is not dependent on the existence of an open, active and orderly market.

Staff accepted that cost of assumption and cost of release were likely to provide relevant information in limited circumstances, but that this was acknowledged in paragraph BC31 of the Basis for Conclusions. Staff suggested that this paragraph might be relocated to the core text. Staff therefore proposed that both cost of assumption and cost of release should be retained in the final Chapter. Members supported this proposal but did not agree with the suggestion to relocate paragraph BC31 to the core text.

Staff agreed with the view expressed by a respondent that some of the discussion of the transfer of a liability in the context of cost of release in paragraph 5.9 of CF–ED3 was more related to recognition than to measurement. Staff agreed with this point and proposed that some of the material in that paragraph should be deleted or moved to the Basis for Conclusions. This approach was accepted.

#### *Other Issues*

Staff highlighted three further issues on which they sought directions:

- Valuation of assets on standalone basis or on the basis that they will be used in conjunction with other assets/liabilities;
- Income-based present value valuation approaches; and
- Other cash flow-based measures.

A respondent to CF–ED3 had suggested that there should be some guidance on whether measurements should be determined on a stand-alone basis or on the basis that they are being used in conjunction with other assets. The Framework had not addressed the unit of account issue. Staff expressed a view that the determination of the appropriate unit of account is a standards-level issue, but that the Conceptual Framework should include a brief allusion to the need at standards level to select the unit of account by reference to the QCs and the constraints on financial reporting.



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A respondent to CF–ED3 had suggested that the Framework should address income-based present value valuation approaches, including the application of discounted cash flow techniques in the context of market or fair value. This proposal was accepted by the IPSASB.

Staff referred back to the point in the Coordinator's Report that the IASB DP had discussed other measurement methods involving estimated future cash flows that do not have the objective of estimating a fair value or market value. Use of such methods included areas where the IPSASB had current IPSASs such as provisions, liabilities for post-employment benefits, the net realizable value of inventories and impairment of non-financial assets. Staff did not think that the Framework needs to go into much detail on these areas, but proposed acknowledging such cash flow based techniques need, so that they can be used in standard setting without conflict with the Framework. Staff considered that cash flow based techniques for provisions and liabilities could be addressed in the cost of fulfillment sub-section of the Liabilities section. The IPSASB accepted this proposal.

In the context of both income-based present value valuation approaches and other cash flow-based measures it was directed that the Framework should not go into detail on how to perform a discounted cash flow computations. It was also noted that cash flow estimation is also used in determining value in use.

#### *Structure of Final Chapter*

Staff proposed a structure for the final chapter that mirrored CF–ED3 except that, in accordance with previous decisions, the section on the Fair Value and Deprival Value models would be deleted. It was suggested that there should be a separate section on the Measurement Objective. This suggestion was supported and the IPSASB directed that the structure should be:

- Introduction
- Measurement Objective and selection of Measurement Bases
- Historical Cost
- Current Value Measurement Bases for Assets
- Measurement Bases for Liabilities
- Basis for Conclusions

#### *Symbolic Values*

A Member expressed disappointment that there is no intention to include a discussion of “symbolic value” in the final chapter. Staff said that a reference would be included in the Basis for Conclusions explaining why “symbolic value” had not been included as a measurement basis.