

Meeting: International Public Sector Accounting
Standards Board

Meeting Location: Toronto, Canada

Meeting Date: March 11-14, 2014

Agenda Item 4B

For:

☐ Approval

☒ Discussion

☐ Information

Conceptual Framework: *Measurement in Financial Statements*

Objective(s) of Agenda Item

1. The objectives of the session are:
 - (b) To **review** a further draft of the final chapter and **provide** directions for further development and finalization.

Material(s) Presented

Agenda Item 4B.1	Issues Paper on Further Draft of Chapter 6, <i>Measurement of Assets and Liabilities in Financial Statements</i>
Agenda Item 4B.2A	Marked-Up Draft of Chapter 6
Agenda Item 4B.2B	Clean Draft of Chapter 6
Agenda Item 4B.3	Draft Minutes December 2013 Meeting

CONCEPTUAL FRAMEWORK: ISSUES PAPER ON FURTHER DRAFT OF CHAPTER 6: MEASUREMENT

Objectives of Issues Paper

1. This aim of this Issues Paper is to highlight key issues in the further draft of Chapter 6, *Measurement of Assets and Liabilities in Financial Statements* so that the IPSASB can provide Staff and the Phase 3 Task Based Group (TBG) with directions for the finalization of the chapter.

Structure of Paper and Key Issues Addressed

2. The paper includes a background section. The paper then addresses a number of key issues on which staff seeks directions or confirmation of their approach:

Background

3. Conceptual Framework Exposure Draft (CF–ED3), *Measurement of Assets and Liabilities in Financial Statements*. CF–ED3 was issued in early November 2012 with a consultation period that expired on April 30th 2013. Thirty nine responses were received. These responses are available on the IPSASB section of the IFAC website. The issues raised by respondents were discussed at the June and September meetings. The decisions of the IPSASB included that the chapter would:
 - Not identify a single measurement basis;
 - Include a measurement objective based on meeting the information needs of users
 - Include fair value rather than market value as a measurement basis;
 - Include replacement cost as a measurement basis in its own right rather than as a method of estimating fair value; and
 - Not include either the fair value model or the deprival value model, both of which were included in CF–ED3.
4. At the December meeting the IPSASB reviewed an initial draft of the final chapter. The IPSASB gave a number of directions for restructuring of the chapter and making the drafting more concise.

Key Issues Addressed in this Paper

5. This section of the paper addresses the following issues:
 - Measurement objective and descriptions of financial capacity and operational capacity
 - Definitions of historical cost
 - Symbolic values
 - Valuation of land under replacement cost measurement basis
 - Discussion of relationship between market value and fair value
6. Staff has highlighted a number of issues in comment boxes on the marked-up version of the draft chapter at Agenda Item 4B.2a. These include both the above areas and other less significant

issues. The boxes also indicate why Staff has modified wording from the version at the December 2013 meeting.

Measurement objective and descriptions of financial capacity and operational capacity

7. CF–ED3 did not include a measurement objective on the basis that a separate objective in addition to the objective of financial reporting stated in Chapter 2, *Objectives and Users of General Purpose Financial Reporting*, was unnecessary. The Alternative View of Mr. Ken Warren challenged this approach and put forward a measurement objective.
8. Following an evaluation of the responses to CF–ED3 the IPSASB confirmed its decision not to identify a single measurement basis and therefore not to have a measurement objective based on a particular measurement basis of group of measurement abuses. However, the IPSASB did decide to develop a measurement objective based on that in the AV. Paragraph 2.2 states the measurement objective:

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

9. Staff is reviewing the draft chapters for consistency with the first four chapters that were published in January 2013. Staff has raised concerns about the use of and meaning of the term “most fairly reflect”. Staff notes that this term was not used in Chapter 2 and considers that it could be confused with the qualitative characteristic (QC) of “faithful representation”, elevating faithful representation above the other QCs. Staff therefore developed modified alternative wording as follows:

To select those measurement bases that provide information about the financial capacity, operational capacity and cost of services that is useful to users of general purpose financial reports for accountability purposes and for decision-making purposes.

10. Staff has discussed this proposed change with Mr. Ken Warren. Mr. Warren is opposed to the proposed Staff changes because he thinks that it dilutes the impact of the measurement objective. He also notes that the IPSASB has devoted considerable time to this objective and that it is strongly supported by members. In light of these reservations Staff has therefore not made any change to the measurement objective in the revised draft final chapter.
11. Staff and one the TBG members have questioned the reference to operational objectives in the description of financial capacity. Staff has therefore revised the description of financial capacity to remove the reference operational objectives. The revised description in paragraph 2.1 is:

The capacity of the entity to continue to fund its activities ~~and meet its operational objectives~~

12. It has also been noted that the format of the description of operational capacity differs from that of financial capacity. Staff has therefore revised the description so that it starts with the phrase “the capacity of the entity”. The revised description in paragraph 2.1 is :

The capacity of the entity to support the provision of services in future periods through physical and other resources

Matter(s) for Consideration

1. Does the IPSASB **support** the retention of the measurement objective as drafted in paragraph 2.2, the proposed staff revision or alternative wording?
2. Does the IPSASB **support** the revisions to the descriptions of financial capacity and operational capacity or alternative wording?

Definitions of historical cost

13. Prior to the Ottawa meeting Staff and the TBG noted that CF–ED3 defined the proposed current value measurement bases for both assets and liabilities, but only provided descriptions of historical cost. Therefore the initial draft chapter for the December meeting included proposed definitions of historical cost. Members considered that the references to ‘market value’ in the proposed definitions did not reflect non-exchange transactions or the service delivery objective of most public sector entities sufficiently and therefore directed Staff to revise the definitions. This direction also reflected the earlier decision to define replacement cost as a measurement basis in its own right rather than as a method of estimating fair value when markets are not active open and orderly.

14. The revised definition for assets is in paragraph 3.1:

The consideration given to acquire an asset, which might be the cash or cash equivalents paid or the market value of the other consideration given at the time of its acquisition or development.

15. The revised definition for liabilities is in paragraph 4.2

The consideration received to assume an obligation, which might be the amount cash or cash equivalents, or the value of the other consideration received at the time the liability is incurred.

Matter(s) for Consideration

3. Does the IPSASB **agree** with the revised definitions of historical cost for assets and liabilities, If not provide alternative wording?

Symbolic Values.

16. In some jurisdictions symbolic values are used. These are amounts at which certain items are recognized on the face of the statement of financial position (or equivalent statement), when it is impossible to obtain a faithfully representative valuation or an accounting policy has been adopted that such items should not be recognized. Such values are often one unit of the presentation currency. Supporters of such values argue that they are important in providing information to users and in demonstrating that an entity owns an asset, which might otherwise be claimed by another entity. The IPSASB considered symbolic values at both the September 2013 and December 2013 meetings.
17. The Staff interpretation of the outcome of the discussion at the December 2013 meeting was principally that (a) the IPSASB directed that symbolic values should not be included as a measurement basis and (b) that the rationale for not including symbolic values as a measurement basis in the Basis for Conclusions (BC) should be made more concise. The BC would not refer to heritage items, because the use of symbolic values is not limited to such items and would state that the reason for not including symbolic values as a measurement basis is that symbolic values do not

meet the measurement objective, because they do not provide useful information on the cost of services, operational capacity or financial capacity. Members also directed that the rationale for symbolic values should also be included. Staff has revised paragraphs BC39 and BC40 to reflect this interpretation of the directions at the December 2013 meeting

18. Staff is aware that at least one member considers that the IPSASB reached a more flexible conclusion that would allow the limited use of symbolic values, as an exception, in circumstances specific to the public sector, where no other valuation is realistic. It is likely that there will be a discussion of this minute in the opening session. Staff seeks clarification on the issue of symbolic values.

Matter(s) for Consideration

4. Could the IPSASB **clarify** whether it directed that symbolic values should be included as a proposed measurement basis?
5. Could the IPSASB **confirm** paragraphs BC39 and BC 40 or provide alternative directions?

Valuation of land under replacement cost

19. In electronic correspondence with staff a respondent to CF–ED3 has questioned the approach to the valuation of land under the replacement cost measurement basis. The issue is best illustrated using the examples of (i) a cemetery and (ii) a school in a residential area that has a higher capacity than currently necessary.
20. In the first example the entity has paid 10 million currency units for land which is subsequently rezoned for use as cemetery. In the first case the issue is whether the cemetery land should reflect the amount that the entity would pay for land be valued at 10 million currency units (or the value of residential land adjoining the cemetery).
21. In the second example a school which is in a residential area has a capacity larger than currently needed and the school is likely to be relocated to a smaller site in a part of the city where land values are considerably lower. In this case the issue is whether the school's measurement should reflect the fact that if replaced it would be relocated to an area where land prices are much lower. In both cases the issue is whether the replacement cost of the land would be the amount that the entity would pay for the land in an active market or whether the value should reflect a public sector specific use,
22. Staff thinks that these are extremely important issues. The issue is whether the IPSASB should seek to address these issues in the Framework or ancillary guidance or whether they should be deferred until a standards level project on Measurement is initiated.
23. Staff notes that the International Valuation Standards Council (IVSC) issued an ED of a Technical Issues Paper (TIP), *Valuations of Specialised Public Service Assets*, in 2011. Staff has previously noted the publication of this document. The ED included a discussion of market value in the context of specialized public sector assets. It noted that "many specialized public service assets include land and the public service use of that land may appear to be sub-optimal." The ED further states that the discussion in the IVSC Framework makes it clear that determination of the highest and best use requires the consideration of uses that are physically possible, legally permissible and financially feasible. The IVSC has not yet developed this ED into a finalized paper and has subsequently narrowed the scope of the project and indicated that it will issue a further exposure

draft. Staff does not think that the current content of the Framework is inconsistent with the above wording in the IVSC's ED

Matter(s) for Consideration

6. To what extent should the IPSASB **provide** more detailed analyses of the implementation of replacement cost in the Framework?

Discussion of relationship between market value and fair value

24. CF-ED3 did not propose fair value as a measurement basis. The principal reason for this was that (a) fair value and market value are very similar if not synonymous and (b) fair value as defined in IFRS 13, *Fair Value*, is explicitly an exit value. The IPSASB has consistently questioned the appropriateness of exit values for assets that are primarily held for service delivery rather than cash generation and where there is no intention to sell. The IPSASB also subsequently acknowledged that the IPSASB's definition of fair value had not kept up with the development of the term globally.
25. CF-ED3 did, however, propose the fair value model as a method of estimating market value where it had been determined that market value is the appropriate measurement basis, but the market is inactive or not open or orderly. Following the consideration of points made by respondents to CF-ED3 the IPSASB decided not to include the fair value model in the final chapter. This was primarily because the IPSASB agreed with those respondents, including those who broadly supported the approach, that the model was too low level and detailed for the Framework. The IPSASB also accepted the view of those respondents who felt that not defining fair value as a measurement basis, but reintroducing fair value through the model was confusing. The Basis for Conclusions in the draft version of the final chapter at the December 2013 meeting did not include the IPSASB's reasons for not including the fair value model in the final chapter. A TBG member highlighted this omission. Staff has therefore drafted paragraphs BC34 and BC 35 to provide details of the IPSASB's deliberations and conclusions on the fair value model.

Matter(s) for Consideration

7. Could the IPSASB **confirm** paragraphs BC40 and BC 41 or provide alternative directions.

Draft Final Pronouncement

*International Public Sector Accounting Standards
Board*

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

Comment [JS1]: Members: Section deleted in accordance with direction at Ottawa meeting

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 (GPFs) 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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BC33.CF–ED3 did not propose fair value as a measurement basis in its own right. However, it proposed the fair value measurement model as a method of estimating a measurement where it had been determined that 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.	<u>35</u>
BC 35.The IPSASB found the views of those who considered the fair value model too low level for the Framework persuasive. The IPSASB also accepted the view of those respondents who felt that not defining fair value as a measurement basis, but reintroducing fair value through the model was confusing. The IPSASB therefore decided not to include the fair value model in the final chapter.	<u>35</u>
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CONCEPTUAL FRAMEWORK FOR GENERAL PURPOSE FINANCIAL REPORTING BY PUBLIC SECTOR ENTITIES:
MEASUREMENT OF ASSETS AND LIABILITIES IN FINANCIAL STATEMENTS

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.

~~4.1.1.2~~ The chapter identifies the measurement bases that may be used in financial statements and how they can be selected. The selection of a measurement basis is important in providing information on the financial position and financial performance of an entity. ~~#The Chapter~~ 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.~~

Comment [JS2]: Deleted in accordance with direction at Ottawa meeting. Reference to financial performance and financial position moved to paragraph 1.1 and reversed so that financial position precedes financial performance.

I'd prefer to retain the reference to revenue, expenses and other elements I also think that it may need to refer to "other resources and other obligations". Do you have views on this?

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

2. The Objective of Measurement

2.1 The selection of a measurement basis contributes to meeting the needs of users in the public sector by providing information for accountability and decision-making purposes by enabling assessments of:

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

2.12.2 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.

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

Entity-Specific and Non-Entity Specific Measures

~~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). **Observable and Unobservable Measures**~~

~~2.7 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.~~

Comment [JS3]: Sub-section relocated after “Entity-Specific and Non-Entity Specific Measures”. Only changes to text marked-up.

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

~~2.92.4~~ It is not possible to ~~select~~ identify a single measurement basis ~~forfor the elements financialin financial~~ statements that ~~will maximize the extent to which information meets~~ fully meet the objectives of financial reporting and the QCs. ~~Therefore~~ 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.

Comment [JS4]: ‘Identify’ has been used because Framework does not prescribe. Staff considers that ‘prescribe’ suggests that the Framework has an authority that it does not possess. TBG member who commented on this point is content with usage of prescribe.

~~2.102.5~~ The following measurement bases for assets are identified and discussed in terms of ~~(a) the suitability of the basis (b(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
- Replacement cost
- Net selling price; and
- Value in use

Table 1 summarizes these measurement bases in terms of whether they (i) provide entry or exit values; (ii) are observable in a market; and (iii) whether or not they are entity-specific.¹

¹ In both Table 1 and Table 2 in some cases a judgment has been made in classifying a particular measurement basis as observable or unobservable in a market and/or as entity or non-entity specific.

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

Table 1: Summary of Measurement Bases for Assets

<u>Measurement Basis</u>	<u>Entry or Exit</u>	<u>Observable or Unobservable in a Market</u>	<u>Entity or Non-entity Specific²</u>
<u>Historical cost</u>	<u>Entry</u>	<u>Generally observable</u>	<u>Entity specific</u>
<u>Market value in open, active and orderly market</u>	<u>Entry and exit are the same</u>	<u>Observable</u>	<u>Non-entity specific</u>
<u>Market value in inactive market</u>	<u>Exit</u>	<u>Dependent on valuation technique</u>	<u>Non-entity specific</u>
<u>Replacement cost</u>	<u>Entry</u>	<u>Observable</u>	<u>Entity specific</u>
<u>Net selling price</u>	<u>Exit</u>	<u>Observable</u>	<u>Entity specific</u>
<u>Value in use</u>	<u>Exit</u>	<u>Unobservable</u>	<u>Entity specific</u>

2.142.6 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.

Table 2 indicates how these measurement bases correspond to the asset definitions and whether they provide entry or exit values.

Table 2: Measurement Bases for Liabilities and Corresponding Asset Terminology

<u>Liabilities</u>	<u>Assets</u>	<u>Entry or Exit</u>
<u>Historical cost</u>	<u>Historical cost</u>	<u>Entry</u>
<u>Market value</u>	<u>Market value</u>	<u>Entry or exit</u>
<u>Cost of release</u>	<u>Net selling price</u>	<u>Exit</u>
<u>Assumption price</u>	<u>Replacement cost</u>	<u>Entry</u>

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

Cost of fulfillment	Value in use	Exit
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Entry and Exit Values

~~2.122.7~~ 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 and replacement cost ~~is an entry value basis~~ are entry values. 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.

~~2.132.8~~ 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.

Entity-Specific and Non-Entity Specific Measures

~~2.142.9~~ 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 and risks that~~ are not available to ~~or experience by~~ other entities. Non-entity specific measures reflect general market opportunities ~~rather than the economic and current policy constraints and risks~~. 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)~~.

Observable and Unobservable Measures

~~2.10~~ ~~Certain measures~~ 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.

Comment [JS5]: Sub-section relocated after “Entity-Specific and Non-Entity Specific Measures”. Only changes to text marked-up.

Level of Aggregation and Disaggregation for Measurement

~~2.152.11~~ In order to ~~measure assets and liabilities in the financial statements in a way that~~ provides information that best meets the measurement objective and QCs it may be necessary to aggregate ~~or disaggregate them, assets and liabilities in the financial statements.~~ An assessment ~~in assessing of whether such an aggregation or disaggregation is appropriate~~ ~~the is appropriate also considers whether the benefits to a particular unit of account are commensurate with the costs of determining that unit of account are also compared with the benefits.~~

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

3. Measurement Bases for Assets

Historical Cost and the Cost Model

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

"The consideration given to acquire an asset, which might be 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/development~~"

3.2 Historical cost is an entry, entity-specific value integral to the cost model. ~~Under the historical cost basis~~³ Under the cost model, assets are initially reported at the cost incurred on their acquisition, ~~including transaction costs~~. Subsequent to initial recognition, this cost ~~may be allocated~~ 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 ~~provided~~ 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 or increases in the value of the asset.

Comment [JS6]: I think that whether transaction costs are reflected in historical cost is a standards-level issue.

Comment [JS7]: Direction at Ottawa meeting was to insert a paragraph on "cost model". I think that the material is already there. Do you agree?

3.3 Under the cost model ~~if~~ 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

Costs of Services

3.54 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.

~~Operational~~ Operational Capacity

3.65 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 or developed, it can be assumed that the value to the entity of its service potential is at least as great as the cost of purchase.⁴ 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

Comment [JS8]: The phrase has been changed from "operating capacity" to "operational capacity" to align with the measurement objective.

³ The term "historical cost" may also be referred to as "cost" or generically as "cost-based measures."

⁴ Where this is not the case the initial historical cost measurement will be reduced by the amount of the impairment.

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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.~~

Comment [JS9]: Sentence not considered necessary.

Financial Capacity

3.7—6 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.

3.7 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 [JS10]: Relocated from paragraph 3.4 in Ottawa meeting version. Staff have reservations whether this paragraph really addresses financial capacity and think the IPSASB should consider its deletion.

Application of the Qualitative Characteristics

3.8 Paragraphs 3.45–3.7 indicate the areas where historical cost provides relevant information in terms of its confirmatory or predictive value. Application of historical cost is often straightforward, ~~because, if 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.

Comment [JS11]: Deleted as previously directed.

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.

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Current Value Measurement Bases

3.11 Current value measurements reflect the economic and financial environment prevailing at the reporting date.

3.12 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

Measurement Basis	Entry or Exit	Observable or Unobservable in a Market	Entity or Non-entity Specific ⁵
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

Comment [JS12]: Table has been relocated to Section Two.

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.

⁵ ~~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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- 3.15 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.
- 3.16 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 price. 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.

Comment [JS13]: Relocated from Suitability section (paragraphs 3.19 and 3.20) of Ottawa version.

Market Values in Open, Active and Orderly Markets⁶

3.15-17 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

3.16-18 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.

Comment [JS14]: Deleted because it is inconsistent with comment in paragraph 3.16.

⁶ 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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~~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 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. , 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

~~3.24~~¹⁹ 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.

~~3.22–20~~ 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~~²¹ 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

Comment [JS15]: Staff notes that direction was to modify to 'prevailing economic conditions'. TBG view that allocation of cost of consumption will be on current value of asset not prevailing economic conditions.

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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.

Operational~~ing~~ Capacity

3.2~~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

3.2~~35~~ 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

3.2~~624~~ 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.

3.2~~725~~ 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

3.2~~826~~ Replacement cost⁷ 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.”

3.2~~927~~ Replacement cost differs from market value because:

- (a) In a public sector context it is explicitly an entry value that reflects the service potential of an asset;
- (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

⁷ 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 3.3~~02~~) The term “replacement cost” is used for economy of expression in the Framework.

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- (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.~~

Comment [JS16]: Staff does not think that this sentence is necessary. The point has already been made adequately in the previous two sentences.

3.3028 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).

3.3429 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.⁸ 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.

3.302 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.~~

Comment [JS17]: Staff does not think that this paragraph is necessary, because most of the points have been made elsewhere. However, Staff thinks that the subsequent paragraph 3.31 is worth retaining.

3.3431 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

⁸ 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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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

3.3532 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.

3.3633 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 as asset values will not be affected by different acquisition dates, 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.

Comment [JS18]: Direction at Ottawa.

Operational Capacity

3.3734 As noted in paragraph 3.3733, 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

3.3835 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.

Comment [JS19]: Staff and TBG member consider this statement inappropriate for Framework.

Application of the Qualitative Characteristics

3.3936 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

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required service potential as discussed in paragraph 3.32–30. Such cases may also prejudice affect the timeliness, comparability and verifiability of information prepared on a replacement cost basis, and will also make it more costly than some alternatives.

3.4037 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

3.4138 Net selling price is defined as:

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

3.4239 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

3.4340 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.

3.4441 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

3.4542 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~~ involve the use of an exit value as the basis of ~~and that the expense reported when they were consumed in the provision of services would be based on that reduced amount.~~

Comment [JS20]: Staff considers that this formulation is clearer.

Operational~~ing~~ Capacity

3.4643 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

- 3.4744 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 such a measure is not relevant of net selling price~~ for assets that may yield more valuable service ~~potential-potential by continuing to use them 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 to deliver services~~.

Comment [JS21]: Deletion is consistent with the deletion of point about disclosure in paragraph 3.35

Application of the Qualitative Characteristics

- 3.4845 As indicated in paragraph 3.47-41 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.
- 3.4946 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

- 3.5047 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

- 3.5148 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 31 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.
- 3.52-49 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.
- 3.5350 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.
- 3.5451 Value in use is an appropriate measurement basis for the assessment of certain impairments, because it is used in the determination of the recoverable amount for an asset or group of assets.

Comment [JS22]: Weakened as debatable whether value in use is appropriate for financial instruments.

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Costs of Services, Operational Capacity, Financial Capacity

3.5552 Because of its complexity⁹, its limited applicability and the fact that its operationalization in a public sector context ~~for non-cash-generating assets 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~~ reduces its relevance for assessments of financial capacity.

Application of the Qualitative Characteristics

- 3.5653 The relevance of value in use is limited to assessments of certain impairments and the circumstances outlined in paragraph 3.5852.
- 3.5754 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.
- 3.5855 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.
- 3.5956 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.
- 3.6057 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.

⁹ See below paragraph 3.5855

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~~(d)~~

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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. It discusses the following measurement bases:

- Historical Cost
- Market Value
- Cost of Release
- Assumption Price

4.4 • Cost of Fulfillment

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

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

Historical Cost

4.34.2 Historical cost for a liability is defined as:

~~"The consideration received to assume an obligation, which might be the amount cash or cash equivalents, or the value of the other consideration received at the time the liability is incurred, or the market value of the other consideration, in the transaction under which the obligation has been assumed."~~

4.3 Under the cost model the initial measures may be adjusted to reflect factors such as the accrual of interest, the accretion of discount or amortization of a premium

Comment [JS23]: Added in accordance with direction at Ottawa. Aim is to be as non-prescriptive as possible.

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). Historical cost is appropriate where liabilities are likely to be settled at stated ~~However~~ terms. 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

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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.

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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~~ 4.15 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~~ 4.16 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~~ 4.17 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~~ 4.18 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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~~4.204.19~~ 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.

~~4.214.20~~ 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.

~~4.224.21~~ 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.

~~4.234.22~~ The cost of fulfilling a liability is the value to the entity of resources that will be used in making fulfillment, and not necessarily the carrying amount at the reporting date.

~~4.244.23~~ 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)

~~4.254.24~~ 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.

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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 GPFs 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 Framework¹⁰. 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.”

Comment [JS24]: See Issues Paper.

¹⁰ Subsequently Chapters 2 and 3.

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- BC5. ~~Many respondents~~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 aspirational and that the Framework should identify a single measurement basis underpinned by an ideal concept of capital¹¹. 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–based measures~~. 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~~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 for standard-setting 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.

Comment [JS25]: Added in accordance with Ottawa direction.

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

¹¹ Such concepts of capital include invested money capital, current cash equivalents and operating capability

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(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.

- 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 [the](#) 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 future revision of a current 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~~[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

Comment [JS26]: Staff considers this modified wording is clearer,

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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~~ 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.~~

Comment [JS27]: Deleted in accordance with Ottawa direction.

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 13.¹²

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

¹² 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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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 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. The IPSASB sees fair value as a model to represent a specific measurement outcome. The IPSASB will carry out further work at standards level to explain how the measurement bases in this chapter align with fair value as implemented in International Financial Reporting Standards.

Comment [JS28]: Inserted as a result of direction at the Ottawa meeting.

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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 current value 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

Comment [JS29]: “Current value” has been inserted to prevent misperception that current value measures superior to cost-based measures.

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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. ~~However it, it~~ proposed the fair value measurement model as a method of estimating a measurement where it had been determined that 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.

BC34. A minority of respondents supported this approach. Some of these respondents thought that the IPSASB should provide further details of its application and others suggested that, although supportive, the model might be too low level for the Framework. . including a view that it should be a standards-level estimation technique. Many respondents put forward a view that fair value should be proposed as a measurement basis in its own right using the definition in IFRS 13, Fair Value Measurement, while other supporters of the IASB definition of fair value wanted more detail on approaches to estimating fair value to complement its adoption as a measurement basis. Conversely other respondents expressed a view that fair value is inappropriate for the public sector

BC 35. The IPSASB found the views of those who considered the fair value model too low level for the Framework persuasive. The IPSASB also accepted the view of those respondents who felt that not defining fair value as a measurement basis, but reintroducing fair value through the model was confusing. The IPSASB therefore decided not to include the fair value model in the final chapter.

Deprival Value Model

~~BC35~~BC36. 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.

BC36BC37. The IPSASB acknowledged such reservations while ~~recognizing the~~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~~measurement basis could not be identified by reference to the objectives of financial reporting and the QCs

BC37BC38. 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 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

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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

BC38BC39. 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. Supporters of symbolic values consider that they provide useful information to users of financial statements and that they demonstrate that the entity owns the item.

BC39BC40. The IPSASB acknowledged that such an approach is intended to provide useful information. ~~The accounting treatment for heritage assets is a standards-level issue. However, the~~ However the majority of IPSASB members took the view that symbolic ~~or nominal approaches~~ values do not meet the measurement objective. ~~This is,~~ 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 majority of the IPSASB concluded that the decision whether to recognize an item as an asset should be made following an assessment of whether the item meets the ~~asset~~ definition of an asset and recognition criteria in Chapter 5.

Comment [JS30]: Section has been modified in accordance with Staff's perception of Ottawa meeting directions. Staff aware that Staff view is not that of all members. Reference to heritage assets has been deleted.

Section 4: Measurement Bases for Liabilities

BC40BC41. 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

BC44BC42. 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.

CONCEPTUAL FRAMEWORK FOR GENERAL PURPOSE FINANCIAL REPORTING BY PUBLIC SECTOR ENTITIES:
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BC43.2. 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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*International Public Sector Accounting Standards
Board*

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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BC 35. The IPSASB found the views of those who considered the fair value model too low level for the Framework persuasive. The IPSASB also accepted the view of those respondents who felt that not defining fair value as a measurement basis, but reintroducing fair value through the model was confusing. The IPSASB therefore decided not to include the fair value model in the final chapter.	27
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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.
- 1.2 The chapter identifies the measurement bases that may be used in financial statements and how they can be selected. The selection of a measurement basis is important in providing information on the financial position and financial performance of an entity. The Chapter does not consider application of these bases to other general purpose financial reports (GPFRs) outside the financial statements.

2. The Objective of Measurement

- 2.1 The selection of a measurement basis contributes to meeting the needs of users in the public sector by providing information for accountability and decision-making purposes by enabling assessments of:
 - (a) Financial capacity—the capacity of the entity to continue to fund its activities;
 - (b) Operational capacity—the capacity of the entity to support the provision of services in future periods through physical and other resources; and
 - (c) The cost of services provided in the period in historical or current terms.
- 2.2 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.*
- 2.3 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.

Measurement Bases and their Selection

- 2.4 It is not possible to identify a single measurement basis for the elements in financial statements that will fully meet the objectives of financial reporting and the QCs. Therefore 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.
- 2.5 The following measurement bases for assets 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

- Replacement cost
- Net selling price; and
- Value in use

Table 1 summarizes these measurement bases in terms of whether they (i) provide entry or exit values; (ii) are observable in a market; and (iii) whether or not they are entity-specific.¹

Table 1: Summary of Measurement Bases for Assets

Measurement Basis	Entry or Exit	Observable or Unobservable in a Market	Entity or Non-entity Specific²
Historical cost	Entry	Generally observable	Entity specific
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

2.6 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.

¹ In both Table 1 and Table 2 in some cases a judgment has been made in classifying a particular measurement basis as observable or unobservable in a market and/or as entity or non-entity specific.

Table 2 indicates how these measurement bases correspond to the asset definitions and whether they provide entry or exit values.

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

Entry and Exit Values

- 2.7 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 and replacement cost are entry values. 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.
- 2.8 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.

Entity-Specific and Non-Entity Specific Measures

- 2.9 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 and risks that are not available to or experience by other entities. Non-entity specific measures reflect general market opportunities and risks. The decision on whether to use an entity-specific or non-entity specific measures is taken by reference to the measurement objective and the QCs.

Observable and Unobservable Measures

- 2.10 Certain 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.

Level of Aggregation and Disaggregation for Measurement

- 2.11 In order to measure assets and liabilities in the financial statements in a way that provides information that best meets the measurement objective and QCs it may be necessary to aggregate or disaggregate them. In assessing whether such an aggregation or disaggregation is appropriate the costs are also compared with the benefits.

3. Measurement Bases for Assets

Historical Cost and the Cost Model

3.1 Historical cost for an asset is:

“The consideration given to acquire an asset, which might be the cash or cash equivalents paid or the market value of the other consideration given at the time of its acquisition or development”

3.2 Historical cost is an entry, entity-specific value integral to the cost model.³ Under the cost model assets are initially reported at the cost incurred on their acquisition. Subsequent to initial recognition, this cost may be allocated as an expense to reporting periods in the form of depreciation or amortization for certain assets, as the service potential and economic benefits provided 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 or increases in the value of the asset.

3.3 Under the cost model 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.

Costs of Services

3.4 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.

Operational Capacity

3.5 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 or developed, it can be assumed that the value to the entity of its service potential is at least as great as the cost of purchase.⁴ 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 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.

³ The term “historical cost” may also be referred to as “cost” or generically as “cost-based measures.”

⁴ Where this is not the case the initial historical cost measurement will be reduced by the amount of the impairment.

Financial Capacity

- 3.6 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.
- 3.7 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.

Application of the Qualitative Characteristics

- 3.8 Paragraphs 3.4–3.7 indicate the areas where historical cost provides relevant information in terms of its confirmatory or predictive value. Application of historical cost is often straightforward, because transaction information is usually readily available. 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 Current value measurements reflect the economic and financial environment prevailing at the reporting date.
- 3.12 There are four current value measurement bases for assets:
- Market value;
 - Replacement cost;
 - Net selling price; and
 - Value in use.

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.
- 3.15 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.
- 3.16 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 price. 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.

Market Values in Open, Active and Orderly Markets⁵

3.17 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

3.18 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.. n 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.

Costs of Services

3.19 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.

3.20 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.

3.21 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.

⁵ 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.

Operational Capacity

- 3.22 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

- 3.23 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.

Application of the Qualitative Characteristics

- 3.24 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.
- 3.25 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

- 3.26 Replacement cost⁶ 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.”

- 3.27 Replacement cost differs from market value because:

- (a) In a public sector context it is explicitly an entry value that reflects the service potential of an asset;
- (b) It includes all the 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. .

- 3.28 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

⁶ 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 3.30) The term “replacement cost” is used for economy of expression in the Framework.

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).

- 3.29 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.⁷ 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.
- 3.30 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.
- 3.31 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

- 3.32 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.
- 3.33 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 as asset values will not be affected by different acquisition dates, 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.

⁷ 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.

Operational Capacity

- 3.34 As noted in paragraph 3.33, 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

- 3.35 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

Application of the Qualitative Characteristics

- 3.36 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 3.30. Such cases may also affect the timeliness, comparability and verifiability of information prepared on a replacement cost basis, and will also make it more costly than some alternatives.
- 3.37 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

- 3.38 Net selling price is defined as:

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

- 3.39 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.
- 3.40 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.
- 3.41 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

- 3.42 It is not appropriate to quantify the cost of the provision of services at net selling prices. Such an approach would involve the use of an exit value as the basis of the expense reported.

Operational Capacity

- 3.43 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

- 3.44 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, such a measure is not relevant for assets that may yield more valuable service potential by continuing to use them to deliver services.

Application of the Qualitative Characteristics

- 3.45 As indicated in paragraph 3.41 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.
- 3.46 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

- 3.47 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

- 3.48 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 3.31 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.
- 3.49 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.

- 3.50 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.
- 3.51 Value in use is an appropriate measurement basis for the assessment of certain impairments, because it is used in the determination of the recoverable amount for an asset or group of assets.

Costs of Services, Operational Capacity, Financial Capacity

- 3.52 Because of its complexity⁸, its limited applicability and the fact that its operationalization in a public sector context for non-cash-generating assets involves 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 its relevance for assessments of financial capacity.

Application of the Qualitative Characteristics

- 3.53 The relevance of value in use is limited to assessments of certain impairments and the circumstances outlined in paragraph 3.52.
- 3.54 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.
- 3.55 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.
- 3.56 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.
- 3.57 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.

⁸ See below paragraph 3.55

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. It discusses the following measurement bases:

- Historical Cost
- Market Value
- Cost of Release
- Assumption Price
- Cost of Fulfillment

Historical Cost

4.2 Historical cost for a liability is defined as:

“The consideration received to assume an obligation, which might be the cash or cash equivalents, or the value of the other consideration received at the time the liability is incurred”.

4.3 Under the cost model the initial measures may be adjusted to reflect factors such as the accrual of interest, the accretion of discount or amortization of a premium

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). Historical cost is appropriate where liabilities are likely to be settled at stated terms. 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 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.

- 4.16 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.
- 4.17 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

- 4.18 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.
- 4.19 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.
- 4.20 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.
- 4.21 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.
- 4.22 The cost of fulfilling a liability is the value to the entity of resources that will be used in making fulfillment, and not necessarily the carrying amount at the reporting date.
- 4.23 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).
- 4.24 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 GPFs 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 Framework⁹. 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

⁹ Subsequently Chapters 2 and 3.

aspirational and that the Framework should identify a single measurement basis underpinned by an ideal concept of capital¹⁰. 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 cost-based measures. 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 for standard-setting 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.

¹⁰ 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 the 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 future revision of a current 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.
- 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 13.¹¹
- BC20. The IPSASB's rationale for the approach proposed in CF–ED3 was that fair value is 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 relevant measurement basis is likely to be net selling price, which reflects the costs of sale and,

¹¹ 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."

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. The IPSASB sees fair value as a model to represent a specific measurement outcome. The IPSASB will carry out further work at standards level to explain how the measurement bases in this chapter align with fair value as implemented in International Financial Reporting Standards.

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 current value 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. CF–ED3 did not propose fair value as a measurement basis in its own right. However, it proposed the fair value measurement model as a method of estimating a measurement where it had been determined that 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.
- BC34. A minority of respondents supported this approach. Some of these respondents thought that the IPSASB should provide further details of its application and others suggested that, although supportive, the model might be too low level for the Framework. , including a view that it should be a standards-level estimation technique. Many respondents put forward a view that fair value should be proposed as a measurement basis in its own right using the definition in IFRS 13, *Fair Value Measurement*, while other supporters of the IASB definition of fair value wanted more detail on approaches to estimating fair value to complement its adoption as a measurement basis. Conversely other respondents expressed a view that fair value is inappropriate for the public sector
- BC35. The IPSASB found the views of those who considered the fair value model too low level for the Framework persuasive. The IPSASB also accepted the view of those respondents who felt that not defining fair value as a measurement basis, but reintroducing fair value through the model was confusing. The IPSASB therefore decided not to include the fair value model in the final chapter.

Deprival Value Model

- BC36. 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.
- BC37. 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
- BC38. 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 of value in use is lower.

Symbolic Values

- BC39. In some jurisdictions certain assets, are recognized on the statement of financial position at symbolic 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. Supporters of symbolic values consider that they provide useful information to users of financial statements and that they demonstrate that the entity owns the item.
- BC40. The IPSASB acknowledged that such an approach is intended to provide useful information. However the majority of IPSASB members took the view that symbolic values do not meet the measurement objective. This is because they do not provide information on financial capacity, operational capacity or the cost of services. The majority of the IPSASB concluded that the decision whether to recognize an item as an asset should be made following an assessment of whether the item meets the definition of an asset and recognition criteria in Chapter 5.

Section 4: Measurement Bases for Liabilities

- BC41. 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

- BC42. 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.
- BC43. 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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Draft Minutes of December 2014 Meeting

The IPSASB considered an Issues Paper covering:

- 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

The IPSASB agreed that historical cost should be defined for both an asset and a liability but considered that the proposed staff definition took into account non-exchange transactions insufficiently and therefore expressed reservations about the reference to 'market value' in the proposed definition. The IPSASB directed that the tentative definition should be:

The consideration given to acquire an asset, which might be the cash or cash equivalents or the value of the other consideration given at the time of its acquisition or development.

The definition for a liability would mirror this. There will also be a short paragraph on the cost model in both the sections on assets and liabilities.

Paragraphs on Suitability of Specific Measurement Bases

It was agreed that, because of the adoption of a specific Measurement Objective, sub-sections on the *Suitability of Specific Measurement Bases* were no longer required. In conjunction with the TBG, staff was asked to consider what material from these sections should be retained in the final Chapter and make proposals for the March meeting.

Symbolic or Nominal Values

The Chair pointed out that the use of the term 'nominal' in the Issues Paper had caused some confusion, because nominal signified a face value¹ that was not adjusted for subsequent changes in value. It was agreed not to use this term and the discussion focused on symbolic values.

¹ In particular the face value of a financial instrument

Some strong opposition was expressed about the non-inclusion of symbolic values as a measurement basis to accommodate certain items where it is not possible to obtain a valuation or where an accounting policy had been adopted that such items should not be valued. Further views were expressed that the use of symbolic values was not limited to heritage items and that the Issues Paper's perceived emphasis on heritage items was unhelpful. For example, symbolic values could be applied to the provision of laboratory facilities and other contributions in kind. It was questioned whether there is any need to refer to heritage assets or particular types of assets. However, the IPSASB reaffirmed the view that symbolic values do not constitute a measurement basis. Staff was directed to ensure that the rationale for including symbolic values as a potential measurement basis is adequately stated in the Basis for Conclusions and that the reason for rejecting such an approach is that symbolic values do not meet the measurement objective.

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

It was agreed that some of the material from the section on the Fair Value model should be relocated to the sub-section on Market Value. However, material on the assumptions that estimation techniques include in paragraph 4.17 was regarded as too low level and the Board agreed that it should be deleted. It was suggested that the Board may want to use the term 'fair value' in standard setting, even though it would not be specified in the Framework.

Net Selling Price

The Board agreed with the staff analysis that the value of an asset would not be displayed at less than zero, but, in the circumstances where the costs of sale are estimated to exceed the proceeds, there is a possibility that a liability might arise from an onerous contract. It was also accepted that under such circumstances the rational approach might be to continue to use the asset rather than immediately sell it. It was agreed that there is no reason to include a reference to this issue in the Basis for Conclusions.

Structure and Format of Section on Liabilities

It was agreed that the structure and format of the section on Liabilities, which is less detailed than that on Assets, should be broadly retained in order to avoid the introduction of repetitive material.

Valuation of Assets on Standalone Basis or on the Basis that they will be used in Conjunction with other Assets/Liabilities (Unit of Account)

It was agreed that there should be a short paragraph on the unit of account, but some reservations were expressed that the Staff drafting was unclear. It was directed that the drafting should be clarified, that the sub-section should be termed the *Level of Aggregation and Disaggregation* rather than *Unit of Account* and that there should be a linkage to recognition.

Income-based Present Value Valuation Measures

The IPSASB agreed that the reference, in the context of estimating market value whether a market is inactive or otherwise not open or orderly, that estimation techniques may include conversion of cash flows to a single discounted amount is adequate.

Other Cash-Flow-Based Measurements

The IPSASB agreed not to add a category: *Other Cash-Flow-Based Measurements* because such measurements are addressed adequately in other measurement bases. It was suggested that this rationale be explained in the Basis for Conclusions.

The IPSASB then carried out a page-by page review and identified a number of editorial and minor changes. The main points identified were:

- When the Chapter is integrated into the finalized Framework there will be no need for the introductory material on the background to the Framework that precedes the core text;
- In paragraph 2.4 it should be noted that replacement cost is an entry value basis;
- The sub-section on 'Observable and Unobservable Measures' should be relocated after the sub-section on 'Entity-Specific and Non-Entity Specific Measures';
- In paragraph 2.7 of the sub-section on 'Entity-Specific and Non-entity Specific Measures' there should be reference to risks as well as opportunities;
- In paragraph 2.9 of the sub-section on 'Measurement Bases and their Selection' the statement that "it is not possible to select a single measurement basis" should be modified to "it is not possible to prescribe a single measurement basis";
- Table 1 in Section 3 (Summary of Current Value Measurement Bases) should summarize the attributes of historical cost as well as the current value measurement bases and be moved to Section 2 (The Objective of Measurement);
- While paragraph 3.17 on estimation techniques should be deleted (as noted above) staff and the TBG should consider the retention of references to models where market values have to be estimated;
- In paragraph 3.36 in the discussion of the information on the cost of services provided by replacement cost there should be reference to comparative information not being affected by different acquisition dates;
- Paragraph 4.15 dealing with the nature of the obligation assumed in the context of assumption price in the section 'Measures for Liabilities' was too low level and should be deleted;
- Table 2 in Section 5, which summarizes measurement bases in terms of whether they are entry or exit values, observable or unobservable in a market and entity or non-entity specific measures should be relocated to Section 2;
- In paragraph BC6 there should be a reference to "standard setting";
- In paragraph BC17 the reference to budgets reflecting anticipated prices during a reporting period should be removed; and
- In paragraph BC24 there should be a reference to the use of 'fair value' at standards level in convergence/alignment with IFRS projects..

It was agreed that a further draft of the final Chapter should be brought to the March 2014 meeting.