

Meeting: International Public Sector Accounting
Standards Board

Meeting Location: Brussels, Belgium

Meeting Date: September 15-18, 2014

Agenda Item 2C

For:

☒ Approval

☒ Discussion

☐ Information

Conceptual Framework: Measurement of Assets and Liabilities in Financial Statements

Objective(s) of Agenda Item

1. The objective of the session is to **approve formally** Chapter 7, *Measurement of Assets and Liabilities in Financial Statements*:

Material(s) Presented

Agenda Item 4C.1A	Marked-Up Version of Chapter 7
Agenda Item 4C.1B	Clean Version of Chapter 7
Agenda Item 4C.2	Draft Minutes of June 2014 Meeting

Background and Approach at Agenda Session

2. The IPSASB directed Staff to make a number of minor changes from the version approved in principle at the December 2014 meeting and to ensure consistency with other chapters of the Framework. Staff circulated a revised version of Chapter 7 on August 21, 2014. This version was marked-up to show changes from the June agenda version.
3. Staff received four sets of comments and have made further changes to Chapter 7 after considering the points raised. The more significant further changes are identified by Staff comments in Comment boxes to the right of the text.
4. Staff proposes that the text is reviewed on an "exception basis" with Staff providing explanations of points that Members consider inadequately explained prior to formal approval.

Matter(s) for Consideration

1. The IPSASB is requested to **approve formally** Chapter 7.

Agenda Item 2C.1A

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

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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.

2. The Objective of Measurement

Staff Comments:

The order of paragraphs 2.1 and 2.2 has been reversed in accordance with the direction at the June meeting.

The order of cost of services, financial capacity, operational capacity and cost of services in the measurement objective in paragraph 2.1 has been reversed in order to align with the sequence in which these attributes are addressed in Sections 3 and 4 on measurement bases for assets and liabilities.

Paragraph 2.9 on "Observable and Unobservable Measures" has been brought forward before paragraph 2.10 on "Entity or Non-Entity Specific Measures" in order to align with Table 1. There has been no substantive change to the text.

In Table 2 the measurement bases have been listed in the same sequence as they are discussed in Section 4.

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

2.1.2 The selection of a measurement basis contributes to meeting the objectives of financial reporting in the public sector by providing information that enables users to assess:

- (a) The cost of services provided in the period in historical or current terms ~~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) Financial capacity—the capacity of the entity to continue to fund its activities ~~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 The selection of a measurement basis also includes an evaluation of the extent to which the information provided achieves the qualitative characteristics (QCs) while taking into account the constraints.

Measurement Bases and their Selection

2.4 It is not possible to identify a single measurement basis that best meets the measurement objective at a Conceptual Framework level. Therefore this Conceptual Framework does not propose a single measurement basis (or combination of bases) for all transactions, events and conditions. It provides

guidance on the selection of a measurement basis for particular assets and liabilities ~~in general 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) And~~ 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 Specific
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	Dependent on valuation technique
Replacement cost	Entry	Observable	Entity specific
Net selling price	Exit	Observable	Entity specific
Value in use	Exit ²	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;
- 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.

² As pointed out in paragraph 3.56, for non-cash-generating assets the calculation of value in use may require the use of ~~replacement cost~~ replacement cost as a proxy surrogate.

Commented [JS1]: Change from August 21st version. Wording considered ambiguous and unnecessary

Commented [JS2]: i.ii,iii, deleted. Change from August 21st version as considered unnecessary.

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

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

Table 2 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.

Table 2: Summary of Measurement Bases for Liabilities

Measurement Basis	Entry or Exit	Observable or Unobservable in a Market	Entity or Non-entity Specific ³
Historical cost	Entry	Generally observable	Entity specific
Cost of fulfillment	Exit	Unobservable	Entity-specific
Market value in open, active and orderly market	Entry and exit <u>are the same</u>	Observable	Non-entity specific
Market value in inactive market	Exit	Dependent on valuation technique	Dependent on valuation technique
Cost of release	Exit	Observable	Entity specific
Assumption price	Entry	Observable	Entity specific

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 economic benefits from 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 supplier tailored to the entity's particular operating requirements for which other market participants would be unwilling to pay a similar price; and
- 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.

Commented [JS3]: Change from August 21st version to refer to entity's operating requirements rather than the source of supply.

Observable and Unobservable Measures

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

2.7

Entity-Specific and Non-Entity Specific Measures

2.82.10 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 and risks that are not experienced 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

2.9 Certain measures may be classified according to whether they are observable in a market. Measures that are observable in a 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/or Disaggregation for Measurement

2.102.11 In order to measure-present 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 for measurement purposes. In assessing whether such an aggregation or disaggregation is appropriate the costs are also compared with the benefits.

3. Measurement Bases for Assets

Staff Comments:

There are minor changes in paragraph 3.4 to harmonize the discussion with the definition of historical cost. In paragraphs 3.5 and 3.13 the qualifying clause that the transaction is an exchange transaction has been added. Also in paragraph 3.5 statements have been added that if an asset has been acquired in a non-exchange transaction "pure" historical cost will not provide information on operating capacity.

In paragraph 3.56 the word "proxy" has been replaced by "surrogate" and additional wording added that this is "for financial reporting purposes."

Historical Cost Model

3.1 Historical cost for an asset is:

"The consideration given to acquire or develop an asset, which is the cash or cash equivalents, or the value of the other consideration, given, at the time of its acquisition or development"

3.2 Historical cost is an entry, entity-specific value.⁴ Under the historical 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 historical cost model is generally modified by reducing 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 (excluding price increases for unimproved assets) or other events, such as the accrual of interest on a financial asset.

Commented [JS4]: Changes from August 21st version.

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 or develop assets consumed in the provision of services. Historical cost generally provides a direct link to the transactions actually undertaken by the entity. 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 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 cumulative price changes since acquisition are significant. Where budgets are prepared on the cost basis, historical cost information demonstrates the extent to which transactions have been in accordance with those budgeted the budget has been executed, and thereby meets the objective of accountability.

Commented [JS5]: Change from version circulated on August 21st. Clarifies that it is all prices changes since acquisition; not just price changes in one reporting period that are significant.

Operational Capacity

⁴ The term "historical cost" may also be referred to as the "cost" model or generically as "cost-based measures."

- 3.5 If an asset has been acquired in an exchange transaction, 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.⁵ 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. If an asset has been acquired in a non-exchange transaction the transaction price will not provide information on operating capacity. In non-exchange transactions another value may be used to determine cost.

Commented [JS6]: Change from August 21st version: "transaction price" has replaced "pure" historical cost", which some found ambiguous.

Commented [JS7]: Change from August 21st version. Added as a result of suggestion on August 21st version.

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 than historical cost.

Commented [JS8]: Acknowledges that current exit values may exceed historical cost.

Application of the Qualitative Characteristics

- 3.7 Paragraphs 3.4–3.6 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 cost to acquire or develop an asset based on actual transactions. 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.
- 3.8 Historical cost information is comparable to the extent that assets have the same or similar acquisition dates and 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.
- 3.9 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.

Commented [JS9]: Change from August 21st version. Drafting clearer.

⁵ Where this is not the case the initial historical cost measurement will be reduced by the amount of the impairment.

Current Value Measurement Bases

3.10 Current value measurements reflect the economic environment prevailing at the reporting date.

3.11 There are four current value measurement bases for assets:

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

Market Value

3.12 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.”

3.13 At acquisition market value and historical cost will be the same, if transaction costs are ignored [and the transaction is an exchange transaction](#). The extent to which market value meets the objectives of financial reporting and the information needs of users partially depends 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 with a view to for sale](#).

3.14 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 [\(see paragraph 3.16\)](#), 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.

3.15 The usefulness of market values is more questionable when the assumption that markets are open, active and orderly [is weakened does not hold](#). 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 and to determine whether an exit-based price or an entry price is the more useful measure](#). 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 [operational capacity](#).

Market Values in Open, Active and Orderly Markets⁶

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

- [There are no barriers that prevent those who wish to the entity from transacting in the market transact from doing so;](#)

Commented [JS10]: Change from August 21st version. Slight wording change as if immediate sale is envisaged net selling price is likely to be more appropriate.

Commented [JS11]:

Commented [JS12]: Change from August 21st version. there may be cases where an entry price is more appropriate

Commented [JS13]: Change from August 21st version. Minor editorial.

Commented [JS14]: Change from August 21st version. Shifts focus onto the which is accounting and makes the characteristic easier to assesses.

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.

- 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 ~~acting without compulsion, so there is assurance of “fairness” in determining current prices (including that prices do not represent distress sales).~~

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~~

- 3.17 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. 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.

Costs of Services

- 3.18 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, as discussed in the Preface, 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. Consequently there may be limited relevance in ~~a comparing the reported return to that implicit in derived from~~ exit-based market prices.
- 3.21 As noted above, revenue from ~~providing~~ 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 includes~~ 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 would be~~ 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 ~~to such markets~~, the relevance of revenue and expenses related to changes in market value is more questionable.

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

Commented [JS15]: Change from August 21st version. Provides explanation of use of “orderly” and “fairness”.

Commented [JS16]: Change from August 21st version.

Commented [JS17]: Change from August 21st version.

Commented [JS18]: Change from August 21st version to clarify that revenue is from providing rather than receiving services.

Commented [JS19]: Change from August 21st version, because “reflects” is ambiguous and could mean that surplus or deficit only includes price changes.

delivering services. However, if exit-based market values are significantly lower than historical cost market value is likely to be less relevant than the historical cost of such assets.

Commented [JS20]: Change from August 21st version

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 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.”

- 3.27 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 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).

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

- 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.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.
- 3.30 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-measure~~ the asset at ~~that value of that service potential~~, as ~~they are it includes future benefits-benefits from future activities~~, 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.

Commented [JS21]: Changes from August 21st version to indicate more clearly that the service potential is that existing at the reporting date

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 the value of the assets~~ 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.

Commented [JS22]: Change from August 21st version for improved clarity of drafting

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.

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.

Financial Capacity

- 3.35 Replacement cost does not provide information on [the](#) amounts that would be received on the sale of [an assets](#). It therefore does not facilitate an assessment of financial capacity.

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 capacity](#) 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 [and includes the entity's costs of sale](#). 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. [The cost of](#)

Commented [JS23]: Change from August 21st version to emphasize entity specific aspect of net selling price.

the provision of services should be measured independently of the revenue those services will generate. Therefore it is inappropriate to use an exit value in determining the expenses recognized.

Commented [JS24]: Change from August 21st version. Change to elaborate assertion in previous sentence.

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 only 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 a timely manner.

Commented [JS25]: Minor change from August 21st version.

Commented [JS26]: Change from August 21st version. Point that it is an entity-specific measure has already been made in paragraph 3.39. Remainder of sentence risks conveying a view that comparability can be equated to "observability".

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 value that 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 that will be derived from an asset 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

Commented [JS27]: Change from August 21st version for consistency with paragraph 3.31.

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 complexity⁹, 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 surrogate, value in use is inappropriate for determining the cost of services. Its usefulness to assessments of operational 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 their value of their service potential or economic benefits in use 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.

Commented [JS28]: Change from August 21st version- inconsistency with use of "surrogate" elsewhere in document as directed at June meeting.

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 are held with the primary objective of contributing to the provision of services (often in non-exchange transactions) rather than to the generation of a commercial return; 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, because such a measure would not be faithfully representative of the value in use of such an asset to the entity. - so it is -Therefore it is necessary to use replacement cost as a proxysurrogate for financial reporting purposes.

Commented [JS29]: Change from August 21st version. Wording is similar to IPSAS 21.

Commented [JS30]: Change from August 21st version. The inserted clause explains the statement in the first part of the sentence.

⁹ See below paragraph 3.55

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

- 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.

4. Measurement Bases for Liabilities

Staff Comments: Paragraph 4.10 (in the June version) has been deleted in accordance with directions at the June meeting.

The other changes are of a minor editorial nature.

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

Historical Cost

4.2 Historical cost for a liability is defined as:

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

4.3 Under the historical cost model 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 difference between the amount of the future payment and the present value of the discount liability 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.

Commented [JS31]: Changed from August 21st version, as it is not the discount that is amortized.

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 unlikely to provide relevant information where the liability has been incurred in a non-exchange transaction, because it does not provide a faithful representation of the claims against the resources of the entity. It is also difficult to apply historical cost to liabilities that may vary in amount, such as those related to defined benefit pension liabilities.

Cost of Fulfillment

4.6 "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.

Commented [JS32]: Change from August 21st version. This sentence could be interpreted as implying double-counting by both paying the counterparty (in the event of non-performance), and the cost of fulfilling the obligation. Staff also thinks that it partially repeats the previous sentence

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

4.8 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 to the entity of doing the remedial work itself, or of contracting with an external party to carry out the work. However, the costs of contracting with an external party are only relevant where employing a contractor is the least costly means of fulfilling the obligation.

~~4.9 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.~~

~~4.144.9~~ 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 claim on the entity's resources. (This is consistent with the approach, for assets where 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).

~~4.10~~ ~~4.10~~ 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.

~~4.113~~ 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.

Market Value

~~4.124~~ 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"

~~4.135~~ 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 that are actively traded, such as much government debt, and 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.

Commented [JS33]: Change from August 21st version. It seems appropriate to include a public sector example.

Cost of Release

~~4.146~~ "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 of 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).

4.64.15 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 4.16 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 4.17 In assessing 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.

4.124.18 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 it is feasible to negotiate a release from the obligation in accordance with the methods in paragraph 4.16.

Assumption Price

4.1943 "Assumption price" is the term used in the context of liabilities to refer to the same concept as "replacement cost" for 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.

4.11 4.20 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.

4.12 4.21 At the time a liability is first incurred in an exchange transaction, 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.

Commented [JS34]: Change from August 21st version to avoid repetition.

4.13 4.22 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.

4.14 4.23 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).

Basis for Conclusions

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

Staff Comment: The second sentence of paragraph BC1 has been deleted. An additional sentence has been added to “round off” the paragraph.

An additional section (BC13 and BC14) has been added on the reason why value in use has been classified as an exit value in accordance with the discussion and directions at the June meeting.

Other changes are editorials and for consistency with other chapters.

Section 1: The Role of Measurement in the [Conceptual Framework](#)

BC1. When the IPSASB initiated Phase 3 of this [Conceptual Framework](#) project, the IPSASB decided that the initial focus should be on measurement of the elements for the financial statements in order to put future standard setting activities for the financial statements on a sound and transparent footing. [The IPSASB acknowledges that there is a need to develop elements for areas of financial reporting outside the financial statements in the future. While a few respondents to the Consultation Paper, Measurement of Assets and Liabilities in Financial Statements, questioned this approach, the IPSASB considered that the original rationale for restricting the scope of this phase was sound and reaffirmed it.](#)

Section 2: The ~~Measurement Objective~~ [Objective of Measurement](#)

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 [Conceptual Framework](#)¹⁰. Accordingly, Exposure Draft, [Elements and Recognition Measurement of Assets and Liabilities in Financial Statements \(CF-ED3the Exposure Draft\)](#) proposed 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-ED3the Exposure Draft](#) envisaged that the [Conceptual Framework](#) would not seek to identify a single measurement basis (or combination of bases) for all circumstances. The IPSASB acknowledged that proposing a single measurement basis to be used in all circumstances would clarify the relationship between different amounts reported in the financial statements: in particular, [it would allow the the amounts of different assets and liabilities could to 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-ED3The Exposure –includedDraft 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 [would limit the ability of the IPSASB to make consistent decisions about measurement across financial](#)

Commented [JS35]: Minor change from August 21st version.

¹⁰ Subsequently Chapters 2 and 3.

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-ED3the Exposure Draft](#), supported the AV. The IPSASB also acknowledged the view that the [Conceptual Framework's](#) approach to measurement should be aspirational and that the [Conceptual Framework](#) should identify a single measurement basis underpinned by an ideal concept of capital¹¹. The IPSASB accepted that the operating capability concept is relevant and could be developed 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~~historical cost measures [in representing operational capacity when financial position is reported](#). 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 [this Conceptual Framework](#).

Commented [JS36]: Change from August 21st version. Clarifies the viewpoint being explained in this paragraph.

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 the reference to "cost of services" provides 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 cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes](#)~~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.~~

Commented [JS37]: Change from August 21st version necessary in accordance with paragraph 2.1

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

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 this [Conceptual 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 [and expense](#) 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.

Entry and Exit Values: Value in Use

BC13. [Measurement bases can be classified according to whether they provide an entry or exit perspective. As discussed in paragraph 2.9 entry values reflect the cost of purchase and exit values reflect either:](#)

Commented [JS38]: Change from August 21st version. Insertion of "expense" is necessary because of subsequent use of "losses".

- (a) The economic benefits from immediate sale; or
(b) The amount that will be derived from the asset from its use and subsequent sale.

The IPSASB considers that awareness of whether a measurement basis is an entry or exit value is useful in determining which measurement basis best meets the measurement objective.

BC14. For a cash-generating asset value in use involves a discounted cash flow model using cash flows from the sale of good and services. For non-cash-generating assets value in use would use the flows for the replacement of the service potential provided by the asset; replacement cost is an entry value. This led to a view that for a non-cash-generating asset value in use has an entry perspective while an asset is being used and an exit perspective when sold; in this view a failure to indicate that value in use contains both entry and exit perspectives does not reflect public sector circumstances. The IPSASB acknowledged this view, but did not think that the use of replacement cost as a surrogate to calculate value in use does not impart the entry perspective of that surrogate. The IPSASB therefore concluded that value in use is an exit value for both cash-generating and non-cash-generating assets.

Commented [JS39]: Change from August 21st version to make clearer and more readable.

Commented [JS40]: The wording in this paragraph has been substantially modified from the August 21st version using wording provided by TBG member.

Section 3: Measurement Bases for Assets

Staff Comments: The first sentence of paragraph BC29 has been deleted in accordance with directions at the June meeting.

The other changes are minor editorials and to paragraph numbering.

Historical Cost

BC153. Historical cost is a widely applied measurement basis in many jurisdictions. Many respondents to the Consultation Paper Consultation Paper and the Exposure – Elements and Recognition in Financial Statements (CF-CP3) and CF-ED3 supported Draft 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 in combination with other measurement bases, its continued use avoids the costs that would arise if a future revision of a current standard that requires or permits historical cost were to require the use of a different measurement basis.

Commented [JS41]: Inserted to avoid suggestion that entities use historical cost across the board.

BC164. 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 is conceptually warranted should be required only where it is judged that the benefits of doing so outweigh the costs of change.

Commented [JS42]: Staff acknowledges the concerns of those that use historical cost during the development of this phase of the Framework that IPSASB would endorse widespread application of current value. Staff has made some drafting changes to put the paragraph in a more conceptual context, but questions whether this statement is appropriate in the final Framework.

BC175. Some respondents considered that historical cost information provides a highly relevant basis for the reporting of the cost of services because 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 how the resources that they have otherwise contributed in a reporting period have been used.

BC1⁸⁶. 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 services.

BC1⁹⁷. 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.

BC2⁰⁴⁸. 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 [Conceptual Framework](#) responds to both these contrasting perspectives.

Market Value and Fair Value

BC2¹⁴⁹. [CF-ED3The Exposure Draft](#) 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 omission of 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, *Fair Value Measurement*, definition of fair value had been used extensively in IPSASB's literature. Many supporters of fair value considered that the definition should mirror that in IFRS 13, issued in May 2011.¹²

BC2²⁰. The IPSASB's rationale for the approach proposed in [CF-ED3the Exposure Draft](#) was that fair value is similar to market value and the inclusion of both measurement bases [is likely to could](#) 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 [\(unlike the definition of fair value in the IPSASB's literature at the time this Conceptual Framework was developed\)](#). 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 operating capacity and the cost of services. 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, and therefore 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.

BC2³⁴. In the public sector many assets are specialized and differences in entry and exit prices are therefore significant. Where an asset will provide [future services potential or other economic benefits that are with a greater value than the asset's than its](#) exit price, a measure reflecting

Commented [JS43]: Minor drafting changes from August 21st version.

Commented [JS44]: Change from August 21st version. Inserted for clarity and to provide context for reader.

¹² The definition in IFRS 13 was used as the definition of fair value in the IASB's Discussion Paper, *A Review of the Conceptual Framework for Financial Reporting*, which characterized fair value as "the most frequently used current value measurement."

exit values is not the most relevant basis. Where the most resource efficient course is to sell the asset (because the value of the service potential or economic benefits that it will provide or the expected cash flows from use is not as great as can be received the value from receivable 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 open, active and orderly market).

Commented [JS45]: Drafting changes from August 21st version to improve flow.

BC242. In considering the merits of fair value (as defined 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 is limited.

BC253. In finalizing the measurement chapter the IPSASB considered three main options in dealing with this issue:

- (i) (a) Adopt the IFRS definition of fair value;
- (ii) (b) Retain ~~its current definition~~ the definition of fair value in IPSAS prior to the development of the Conceptual Framework; or
- (iii) (c) Include market value rather than fair value as a measurement basis as proposed in CF-ED3.

Commented [JS46]:

Commented [JS47R46]: Change from August 21st version.

BC264. 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.

Commented [JS48]: Drafting change from August 21st version. Point on feasibility of transfer may not be restricted to liabilities arising from non-exchange transactions.

BC275. ~~Retaining-Including~~ the IPSASB's current definition of fair value or a slightly modified version of the ~~current definition~~ that definition in the ~~IPSASB literature~~ Conceptual Framework would have meant that two global standard setters would have different conceptual definitions of the same term.

Commented [JS49]: Minor drafting changes from August 21st version.

BC286. The IPSASB acknowledged that the non-inclusion of fair value would have implications for the IPSASB's extant literature at the time this Conceptual Framework was finalized, because a number of IPSAS's contained fair value in measurement requirements or options.

BC297. ~~The IPSASB accepted 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 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, this Conceptual Framework should include market value ~~should be included~~ as a measurement basis ~~in the Framework~~ rather than fair value. 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.

Commented [JS50]: Minor drafting changes from August 21st version to improve flow.

Replacement Cost, Net Selling Price and Value in Use

BC3028. 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.

BC3129. 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.

BC320. 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. The IPSASB acknowledged that guidance will be necessary at standards level on the approach to implementation of replacement cost.

BC334. 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 t~~Under these circumstances ~~he IPSASB concluded that~~ an entity specific measurement basis that reflects the constraints on sale for an entity ~~and provides an exit value~~ is more appropriate. The IPSASB concluded that net selling price ~~is the most appropriate basis~~best meets the measurement objective. 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 it 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.

BC342. 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. ~~Value in use includes the cash flows or~~

Commented [JS51]: Drafting changes from August 21st version. Reference to fair value less costs to sell is confusing because fair value is not included as a measurement basis in the Framework.

[service potential from continued operation of the asset and the proceeds of sale.](#) 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 context, and that, in determining value in use, it might therefore be necessary to use replacement cost as a surrogate.

Commented [JS52]: Changes from August 21st version.

Fair Value Model

BC353. As indicated in paragraph BC19, [CF-ED3the Exposure Draft](#) 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.

BC364. A minority of respondents supported the fair value measurement model. Some of these respondents thought that the IPSASB should provide further details of its application. Others were supportive of the model, but suggested that [might be too low level for the Framework a detailed measurement model would be inappropriate for the Conceptual Framework](#); some considered that it should be [addressed as](#) 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, 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

Commented [JS53]: Minor change from August 21st version.

BC375. The IPSASB found the views of those who considered the fair value model too low level for the [Conceptual](#) 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

BC386. [CF-GP3The Consultation Paper](#) discussed the deprival value model as providing a rationale for selecting a current value basis. Some respondents expressed reservations about the use of the deprival value; 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. A view was also expressed that the deprival value model unduly exaggerates the QC of relevance and neglects the other QCs.

BC397. While recognizing [that](#) the deprival value model has been adopted successfully in some jurisdictions the IPSASB acknowledged such reservations [in whole or part](#). The IPSASB included the deprival value model in [CF-ED3the Exposure Draft](#) as an optional method of choosing between replacement cost, net selling price and value in use where it had been decided to use a current measurement basis, but the appropriate basis could not be identified by reference to the objectives of financial reporting and the QCs

BC4038. While a minority of respondents to [CF-ED3the Exposure Draft](#) were highly supportive of the deprival value model many respondents continued to express reservations about the model's complexity. The IPSASB also acknowledged a technical ambiguity in the deprival value model that

if net selling price is higher than replacement cost a development opportunity might be indicated and that users should be provided with this information, which the deprival value model would not do. Due to these factors the IPSASB decided not to include the deprival value model in the [Conceptual Framework](#). ~~However, some of , while retaining some of~~ the insights provided by the model in its analysis of [the relationship between](#) replacement cost, net selling price and value in use [have been retained](#); for example, that it is inappropriate to measure an asset at replacement cost if the higher of net selling price or value in use is lower than replacement cost.

Symbolic Values

BC4139. 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. Supporters of symbolic values consider that they provide useful information to users of financial statements and facilitate a linkage between asset management and accounting processes.

BC420. 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 in Chapter 5 and recognition criteria in Chapter 6. The IPSASB also accepted that, in cases where, it is impossible or very costly to obtain a valuation, it is important that the information to be provided through disclosures is carefully considered at standards level.

Section 4: Measurement Bases for Liabilities

Staff Comments: Additional material has been added to paragraphs BC43 explaining the decision to retain assumption price. The other changes are editorials.

BC43. ~~The IPSASB concluded that the principles of measurement that apply to assets are 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. ~~The IPSASB accepted that the circumstances under which assumption price will meet the measurement objective are limited. However, insurance and similar obligations, such as financial guarantees, are liabilities where assumption price might provide relevant and faithfully representative information. In such cases liabilities might be revalued at assumption price to reflect changes in risk premia following initial recognition.~~

Commented [JS54]: Minor drafting changes from August 21st version.

BC44. ~~Some respondents to the Exposure Draft also questioned whether cost of release should be included. The IPSASB acknowledged that. Furthermore, in many cases in the public sector, particularly for non-exchange transactions, there is unlikely to be a cost of release, because, the there will not be a creditor is unlikely to accept a sum lower than cost of fulfillment in settlement, and instances where an external third party would willing to accept the transfer of such a liability from the obligor for a specified amount are likely to be rare. Even where a cost of release can be determined the external party is unlikely to accept a sum lower than cost of fulfillment in settlement.~~ 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~~ assumption price and the cost of release as measurement bases in the Conceptual Framework as there may be limited circumstances where these measurement bases meet the measurement objective.

Commented [JS55]: Minor change from August 21st version.

Other Issues

BC46. ~~CF-CP3~~ The Consultation Paper 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.

BC45. The majority of respondents who provided comments on these issues considered that they were more appropriately dealt with at the standards level rather than within the Conceptual Framework. The IPSASB concurred with this view, and these issues are accordingly not addressed in the Conceptual 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.

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

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Agenda Item 2C.1B

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

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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.

2. The Objective of Measurement

Staff Comments:

The order of paragraphs 2.1 and 2.2 has been reversed in accordance with the direction at the June meeting.

The order of cost of services, financial capacity, operational capacity and cost of services in the measurement objective in paragraph 2.1 has been reversed in order to align with the sequence in which these attributes are addressed in Sections 3 and 4 on measurement bases for assets and liabilities.

Paragraph 2.9 on “Observable and Unobservable Measures” has been brought forward before paragraph 2.10 on “Entity or Non-Entity Specific Measures” in order to align with Table 1. There has been no substantive change to the text.

In Table 2 the measurement bases have been listed in the same sequence as they are discussed in Section 4.

- 2.1 The objective of measurement is: “To select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity 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 objectives of financial reporting in the public sector by providing information that enables users to assess:
 - (a) The cost of services provided in the period in historical or current terms;
 - (b) Operational capacity—the capacity of the entity to support the provision of services in future periods through physical and other resources; and
 - (c) Financial capacity—the capacity of the entity to continue to fund its activities.
- 2.3 The selection of a measurement basis also includes an evaluation of the extent to which the information provided achieves the qualitative characteristics (QCs) while taking into account the constraints.

Measurement Bases and their Selection

- 2.4 It is not possible to identify a single measurement basis that best meets the measurement objective at a Conceptual Framework level. Therefore this Conceptual Framework does not propose a single measurement basis (or combination of bases) for all transactions, events and conditions. It provides guidance on the selection of a measurement basis for particular assets and liabilities 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 the cost of services delivered by an entity, the operating capacity of an entity And 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 Specific
Historical cost	Entry	Generally observable	Entity specific
Market value in open, active and orderly market	Entry and exit	Observable	Non-entity specific
Market value in inactive market	Exit	Dependent on valuation technique	Dependent on valuation technique
Replacement cost	Entry	Observable	Entity specific
Net selling price	Exit	Observable	Entity specific
Value in use	Exit ²	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;
- Cost of fulfillment;
- Market value;
- Cost of release; and
- Assumption price.

Table 2 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 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.

² As pointed out in paragraph 3.56, for non-cash-generating assets the calculation of value in use may require the use of replacement cost as surrogate.

Table 2: Summary of Measurement Bases for Liabilities

Measurement Basis	Entry or Exit	Observable or Unobservable in a Market	Entity or Non-entity Specific³
Historical cost	Entry	Generally observable	Entity specific
Cost of fulfillment	Exit	Unobservable	Entity-specific
Market value in open, active and orderly market	Entry and exit	Observable	Non-entity specific
Market value in inactive market	Exit	Dependent on valuation technique	Dependent on valuation technique
Cost of release	Exit	Observable	Entity specific
Assumption price	Entry	Observable	Entity specific

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 economic benefits from 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 tailored to the entity's particular operating requirements for which other market participants would be unwilling to pay a similar price; and
- 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.

Observable and Unobservable Measures

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

Entity-Specific and Non-Entity Specific Measures

2.10 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

and risks that are not experienced 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.

Level of Aggregation or Disaggregation for Measurement

- 2.11 In order to present 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 for measurement purposes. In assessing whether such an aggregation or disaggregation is appropriate the costs are compared with the benefits.

3. Measurement Bases for Assets

Staff Comments:

There are minor changes in paragraph 3.4 to harmonize the discussion with the definition of historical cost. In paragraphs 3.5 and 3.13 the qualifying clause that the transaction is an exchange transaction has been added. Also in paragraph 3.5 statements have been added that if an asset has been acquired in a non-exchange transaction “pure” historical cost will not provide information on operating capacity. In paragraph 3.56 the word “proxy” has been replaced by “surrogate” and additional wording added that this is “for financial reporting purposes.”

Historical Cost Model

3.1 Historical cost for an asset is:

“The consideration given to acquire or develop an asset, which is the cash or cash equivalents, or the value of the other consideration, given, at the time of its acquisition or development”

3.2 Historical cost is an entry, entity-specific value.⁴ Under the historical 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 The historical cost model is generally modified by reducing the amount of an asset in 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 (excluding price increases for unimproved assets) 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 or develop assets consumed in the provision of services. Historical cost generally provides a direct link to the transactions actually undertaken by the entity. 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 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 cumulative price changes since acquisition are significant. Where budgets are prepared on the cost basis, historical cost information demonstrates the extent to which the budget has been executed.

⁴ The term “historical cost” may also be referred to as the “cost” model or generically as “cost-based measures.”

Operational Capacity

- 3.5 If an asset has been acquired in an exchange transaction, the historical cost basis provides information on the resources available to provide services in future periods, based on its 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.⁵ 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. If an asset has been acquired in a non-exchange transaction the transaction price will not provide information on operating capacity, in non-exchange transactions, another value may be used to determine cost.

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 different.

Application of the Qualitative Characteristics

- 3.7 Paragraphs 3.4–3.6 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 cost to acquire or develop an asset based on actual transactions. 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.
- 3.8 Historical cost information is comparable to the extent that assets have the same or similar acquisition dates. 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.
- 3.9 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.

⁵ Where this is not the case the initial historical cost measurement will be reduced by the amount of the impairment.

Current Value Measurement Bases

3.10 Current value measurements reflect the economic environment prevailing at the reporting date.

3.11 There are four current value measurement bases for assets:

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

Market Value

3.12 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.”

3.13 At acquisition market value and historical cost will be the same, if transaction costs are ignored and the transaction is an exchange transaction. The extent to which market value meets the objectives of financial reporting and the information needs of users partially depends 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 with a view to sale.

3.14 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 (see paragraph 3.16), 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.

3.15 The usefulness of market values is more questionable when the assumption that markets are open, active and orderly does not hold. 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 determine whether an exit price or an entry price is the more useful measure. 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 operational capacity.

Market Values in Open, Active and Orderly Markets⁶

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

- There are no barriers that prevent the entity from transacting in the market;

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.

- 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 acting without compulsion, so there is assurance of “fairness” in determining current prices (including that prices do not represent distress sales).

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

- 3.17 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. 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.

Costs of Services

- 3.18 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, as discussed in the Preface, 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. Consequently there may be limited relevance in a reported return derived from exit-based market prices.
- 3.21 As noted above, revenue from providing 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 includes 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 would be 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 to such markets, the relevance of revenue and expenses related to changes in market value is more questionable.

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 the historical cost of such assets.

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 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.”

- 3.27 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 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).

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

- 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. ⁸Although 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 that will be derived from an asset will be greater than its replacement cost. However, it would not be appropriate to measure the asset at that value, as it includes benefits from future activities, 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 the value of the assets 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.

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.

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.

Financial Capacity

- 3.35 Replacement cost does not provide information on the amounts that would be received on the sale of assets. It therefore does not facilitate an assessment of financial capacity.

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 capacity 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 and includes the entity's costs of sale. 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. The cost of the

provision of services should be measured independently of the revenue those services will generate. Therefore it is inappropriate to use an exit value in determining the expenses recognized.

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 provides relevant information only 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.
- 3.46 In most cases where net selling price is relevant, it will be adequately representationally faithful, verifiable and capable of being produced in a 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 value that 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 that will be derived from an asset 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 complexity⁹, 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 a surrogate, value in use is inappropriate for determining the cost of services. Its usefulness to assessments of operational 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 their value in use 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 are held with the primary objective of contributing to the provision of services (often in non-exchange transactions) rather than to the generation of a commercial return: 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, because such a measure would not be faithfully representative of the value in use of such an asset to the entity. Therefore it is necessary to use replacement cost as a surrogate for financial reporting purposes.
- 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.

⁹ See below paragraph 3.55

4. Measurement Bases for Liabilities

Staff Comments: Paragraph 4.10 (in the June version) has been deleted in accordance with directions at the June meeting.

The other changes are of a minor editorial nature.

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

Historical Cost

4.2 Historical cost for a liability is defined as:

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

4.3 Under the historical cost model 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 difference between the amount of the future payment and the present value of the liability 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 unlikely to provide relevant information where the liability has been incurred in a non-exchange transaction, because it does not provide a faithful representation of the claims against the resources of the entity. It is also difficult to apply historical cost to liabilities that may vary in amount, such as those related to defined benefit pension liabilities.

Cost of Fulfillment

4.6 “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.

4.7 Where the cost of fulfillment depends on uncertain future events, all possible outcomes are taken into account in the estimated cost of fulfillment, which should aim to reflect all those possible outcomes in an unbiased manner.

- 4.8 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 to the entity of doing the remedial work itself, or of contracting with an external party to carry out the work. However, the costs of contracting with an external party are only relevant where employing a contractor is the least costly means of fulfilling the obligation.
- 4.9 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 claim on the entity's resources. (This is consistent with the approach, for assets where 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).
- 4.10 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.
- 4.11 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.

Market Value

- 4.12 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”

- 4.13 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 that are actively traded, such as much government debt, and 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

- 4.14 “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 of 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).

- 4.15 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).
- 4.16 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 remains a liability of the entity.
- 4.17 In assessing 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.
- 4.18 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 it is feasible to negotiate a release from the obligation in accordance with the methods in paragraph 4.16.

Assumption Price

- 4.19 "Assumption price" is the term used in the context of liabilities to refer to the same concept as "replacement cost" for 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.
- 4.20 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.
- 4.21 At the time a liability is first incurred in an exchange transaction, 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.
- 4.22 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.

- 4,23 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).

Basis for Conclusions

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

Staff Comment: The second sentence of paragraph BC1 has been deleted. An additional sentence has been added to “round off” the paragraph.

An additional section (BC13 and BC14) has been added on the reason why value in use has been classified as an exit value in accordance with the discussion and directions at the June meeting.

Other changes are editorials and for consistency with other chapters.

Section 1: The Role of Measurement in the Conceptual Framework

BC1. When the IPSASB initiated Phase 3 of this Conceptual Framework project, the IPSASB decided that the initial focus should be on measurement of the elements for the financial statements in order to put future standard setting activities for the financial statements on a sound and transparent footing. While a few respondents to the Consultation Paper, *Measurement of Assets and Liabilities in Financial Statements*, questioned this approach, the IPSASB considered that the original rationale for restricting the scope of this phase was sound and reaffirmed it.

Section 2: The Objective of Measurement

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 Conceptual Framework¹⁰. Accordingly, Exposure Draft, *Measurement of Assets and Liabilities in Financial Statements* (the Exposure Draft) proposed 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 the Exposure Draft envisaged that the Conceptual Framework would not seek to identify a single measurement basis (or combination of bases) for all circumstances. The IPSASB acknowledged that proposing a single measurement basis to be used in all circumstances would clarify the relationship between different amounts reported in the financial statements: in particular, it would allow the amounts of different assets and liabilities to 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. The Exposure Draft 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 would 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:

¹⁰ Subsequently Chapters 2 and 3.

“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 the Exposure Draft, supported the AV. The IPSASB also acknowledged the view that the Conceptual Framework’s approach to measurement should be aspirational and that the Conceptual Framework should identify a single measurement basis underpinned by an ideal concept of capital¹¹. The IPSASB accepted that the operating capability concept is relevant and could be developed 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 measures in representing operational capacity when financial position is reported. 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 this Conceptual 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 the reference to “cost of services” provides 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:
- BC8. *To select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes.* 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.

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

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 this Conceptual 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 and expense 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.

Entry and Exit Values: Value in Use

- BC13. Measurement bases can be classified according to whether they provide an entry or exit perspective. As discussed in paragraph 2.9 entry values reflect the cost of purchase and exit values reflect either:
- (a) The economic benefits from immediate sale; or
 - (b) The amount that will be derived from the asset from its use and subsequent sale.

The IPSASB considers that awareness of whether a measurement basis is an entry or exit value is useful in determining which measurement basis best meets the measurement objective.

- BC14. For a cash-generating asset value in use involves a discounted cash flow model using cash flows from the sale of good and services. For non-cash-generating assets value in use would use the flows for the replacement of the service potential provided by the asset; replacement cost is an entry value. This led to a view that for a non-cash-generating asset value in use has an entry perspective while an asset is being used and an exit perspective when sold; in this view a failure to indicate that value in use contains both entry and exit perspectives does not reflect public sector

circumstances. The IPSASB acknowledged this view, but did not think that the use of replacement cost as a surrogate to calculate value in use does not impart the entry perspective of that surrogate. The IPSASB therefore concluded that value in use is an exit value for both cash-generating and non-cash-generating assets.

Section 3: Measurement Bases for Assets

Staff Comments: The first sentence of paragraph BC29 has been deleted in accordance with directions at the June meeting.

The other changes are minor editorials and to paragraph numbering.

Historical Cost

- BC15. Historical cost is a widely applied measurement basis in many jurisdictions. Many respondents to the Consultation Paper and the Exposure Draft 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 in combination with other measurement bases, its continued use avoids the costs that would arise if a future revision of a current standard that requires or permits historical cost were to require the use of a different measurement basis.
- BC16. The IPSASB agreed that historical cost is generally understandable and verifiable and that, a change to another measurement basis is conceptually warranted only where it is judged that the benefits of doing so outweigh the costs of change.
- BC17. Some respondents considered that historical cost information provides a highly relevant basis for the reporting of the cost of services because 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 how the resources that they have otherwise contributed in a reporting period have been used.
- BC18. 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 services.
- BC19. 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.
- BC20. 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 Conceptual Framework responds to both these contrasting perspectives.

Market Value and Fair Value

- BC21. The Exposure Draft 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 omission of fair value as a measurement basis. 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, *Fair Value Measurement*, definition of fair value had been used extensively in IPSASB's literature. Many supporters of fair value considered that the definition should mirror that in IFRS 13, issued in May 2011.¹²
- BC22. The IPSASB's rationale for the approach proposed in the Exposure Draft was that fair value is similar to market value and the inclusion of both measurement bases could 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 (unlike the definition of fair value in the IPSASB's literature at the time this Conceptual Framework was developed). 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 operating capacity and the cost of services. 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, and therefore 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.
- BC23. In the public sector many assets are specialized and differences in entry and exit prices are therefore significant. Where an asset will provide future services or economic benefits with a greater value than the asset's 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 value of the services that it will provide or the expected cash flows from use is not as great as the value receivable 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 open, active and orderly market).
- BC24. In considering the merits of fair value (as defined 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 is limited.
- BC25. In finalizing the measurement chapter the IPSASB considered three main options in dealing with this issue:
- (a) Adopt the IFRS definition of fair value;
 - (b) Retain the definition of fair value in IPSAS prior to the development of the Conceptual Framework; or

¹² The definition in IFRS 13 was used as the definition of fair value in the IASB's Discussion Paper, *A Review of the Conceptual Framework for Financial Reporting*, which characterized fair value as "the most frequently used current value measurement."

- (c) Include market value rather than fair value as a measurement basis as proposed in CF–ED3.
- BC26. 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 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.
- BC27. Including the IPSASB's current definition of fair value or a slightly modified version of that definition in the Conceptual Framework would have meant that two global standard setters would have different conceptual definitions of the same term.
- BC28. The IPSASB acknowledged that the non-inclusion of fair value would have implications for the IPSASB's extant literature at the time this Conceptual Framework was finalized, because a number of IPSAS's contained fair value in measurement requirements or options.
- BC29. On balance the 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, this Conceptual Framework should include market value as a measurement basis rather than fair value. 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

- BC30. As discussed in *the Preface to the Conceptual Framework* the objective of public sector entities is to deliver 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.
- BC31. 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 service potential that is attributable to an asset.
- BC32. 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. The IPSASB acknowledged that guidance will be necessary at standards level on the approach to implementation of replacement cost.

- BC33. 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. Under these circumstances an entity specific measurement basis that reflects the constraints on sale for an entity and provides an exit value is more appropriate. The IPSASB concluded that net selling price best meets the measurement objective. Net selling price is therefore included as a measurement basis in section 3 of this chapter. 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.
- BC34. 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. Value in use includes the cash flows or service potential from continued operation of the asset and the proceeds of sale. 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 context, and that, in determining value in use, it might therefore be necessary to use replacement cost as a surrogate.

Fair Value Model

- BC35. As indicated in paragraph BC19, the Exposure Draft 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 is the appropriate measurement basis, but the market is inactive or otherwise not open or orderly.
- BC36. A minority of respondents supported the fair value measurement model. Some of these respondents thought that the IPSASB should provide further details of its application. Others were supportive of the model, but suggested that a detailed measurement model would be inappropriate for the Conceptual Framework; some considered that it should be addressed as 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, 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
- BC37. The IPSASB found the views of those who considered the fair value model too low level for the Conceptual 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

- BC38. The Consultation Paper discussed the deprival value model as providing a rationale for selecting a current value basis. Some respondents expressed reservations about the use of the deprival value; 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. A view was also expressed that the deprival value model unduly exaggerates the QC of relevance and neglects the other QCs.
- BC39. While recognizing that the deprival value model has been adopted successfully in some jurisdictions the IPSASB acknowledged such reservations in whole or part. The IPSASB included the deprival value model in the Exposure Draft as an optional method of choosing between replacement cost, net selling price and value in use where it had been decided to use a current measurement basis, but the appropriate basis could not be identified by reference to the objectives of financial reporting and the QCs
- BC40. While a minority of respondents to the Exposure Draft were highly supportive of the deprival value model many respondents continued to express reservations about the model's complexity. The IPSASB also acknowledged a technical ambiguity in the deprival value model that if net selling price is higher than replacement cost a development opportunity might be indicated and that users should be provided with this information, which the deprival value model would not do. Due to these factors the IPSASB decided not to include the deprival value model in the Conceptual Framework. However, some of the insights provided by the model in its analysis of the relationship between replacement cost, net selling price and value in use have been retained; for example, that it is inappropriate to measure an asset at replacement cost if the higher of net selling price or value in use is lower than replacement cost.

Symbolic Values

- BC41. 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. Supporters of symbolic values consider that they provide useful information to users of financial statements and facilitate a linkage between asset management and accounting processes.
- BC42. 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 in Chapter 5 and recognition criteria in Chapter 6. The IPSASB also accepted that, in cases where, it is impossible or very costly to obtain a valuation, it is important that the information to be provided through disclosures is carefully considered at standards level.

Section 4: Measurement Bases for Liabilities

Staff Comments: Additional material has been added to paragraphs BC43 explaining the decision to retain assumption price. The other changes are editorials.

- BC43. The IPSASB acknowledged the views of those who noted that, because, as highlighted in *the Preface to the Conceptual Framework*, many services are provided by public sector entities in non-exchange transactions there will often not be an assumption price. The IPSASB accepted that the circumstances under which assumption price will meet the measurement objective are limited. However, insurance and similar obligations, such as financial guarantees, are liabilities where assumption price might provide relevant and faithfully representative information. In such cases liabilities might be revalued at assumption price to reflect changes in risk premia following initial recognition.
- BC44. Some respondents to the Exposure Draft also questioned whether cost of release should be included. The IPSASB acknowledged that in many cases in the public sector, particularly for non-exchange transactions, there is unlikely to be a cost of release, because there will not be an external party willing to accept the transfer of a liability from the obligor for a specified amount. Even where a cost of release can be determined the external party is unlikely to accept a sum lower than cost of fulfillment in settlement. 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 assumption price and the cost of release as measurement bases in the Conceptual Framework as there may be limited circumstances where these measurement bases meet the measurement objective.

Other Issues

- BC46. The Consultation Paper 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.
- BC45. The majority of respondents who provided comments on these issues considered that they were more appropriately dealt with at standards level rather than in the Conceptual Framework. The IPSASB concurred with this view, and these issues are accordingly not addressed in the Conceptual 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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Conceptual Framework: Measurement

The IPSASB considered two key issues identified by staff:

- Classification of value in use as reflecting entry or exit perspectives; and
- Retention of assumption price as a current value measurement basis for liabilities

Classification of value in use as reflecting entry or exit perspectives

At the March meeting the IPSASB concluded that value in use reflects both entry and exit perspectives, because, for non-cash-generating assets its determination relies on the use of replacement cost, which reflects an entry perspective. In accordance with this decision the table summarizing measurement bases for assets in section two had been amended. Staff questioned this classification on the grounds that it appeared to conflict with both the description of an exit perspective and the definition of value in use. A contrary view was expressed that value in use has an entry perspective while an asset is being used and an exit perspective when sold; in this view a failure to indicate that value in use contains both entry and perspectives does not reflect public sector circumstances. Following considerable discussion it was agreed that value in use should be classified as an exit value with a footnote indicating that its implementation for non-cash-generating assets requires the use of replacement cost and an appropriate explanation in the Basis for Conclusions. It was also agreed that the use of replacement cost in the determination of value in use should be described as a “surrogate” not a “proxy”.

Retention of assumption price

Staff expressed reservations whether assumption price should be retained as one of the four current value measurement bases for liabilities because:

- (a) It was unclear how it related to historical cost;
- (b) There are practical problems in reflecting price changes in assumption price; and
- (c) Assumption price was an inheritance from the cost of relief model and staff had reservations whether it would be used for standard setting purposes.

A member identified insurance and similar obligations as areas where assumption price might provide relevant and faithfully representative information. In such cases liabilities might be revalued at assumption price to reflect changes in risk premia following initial recognition. It was therefore decided to retain assumption price as a current value measurement basis for liabilities and provide an explanation in the Basis for Conclusions of the IPSASB's reasons for its retention, and appreciation that it is not necessarily common.

Page-by-page review

The IPSASB carried out a page-by-page review of the draft chapter and identified a number of drafting and editorial changes. In particular the IPSASB directed that the sequence of the analysis of whether, and the extent to which, measurement bases provide information on financial capacity, operational capacity and cost of services should be aligned with the sequence of these terms in the measurement objective. The other more significant changes were to:

- Note in the discussion of the extent to which historical cost provides information on operational capacity in the section on “measurement bases for assets” that if an asset has been acquired

in a non-exchange transaction “pure” historical cost will not provide information on operating capacity;

- Qualify the statement that “at acquisition market value and historical cost will be the same, if transaction costs are ignored by adding “and the transaction is an exchange transaction;”
- Delete paragraph 4.10 which stated that 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;” and
- Delete the statement in paragraph BC1 that “ the IPSASB acknowledges that there is a need to develop elements for areas of financial reporting outside the financial statements in the future;” and
- Delete the statement in paragraph BC27 that the IPSASB’s “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.”

The IPSASB also noted that the listing of measurement bases for liabilities in section one did not reflect the order in why they are discussed in section four. This inconsistency should be rectified.

Approval in principle

The IPSASB approved the Measurement chapter in principle. 16 members voted in favor, with zero against, one abstention and two members absent. Final approval is planned for the September 2014 IPSASB meeting.