

Meeting: International Public Sector Accounting
Standards Board

Meeting Location: Toronto, Canada.

Meeting Date: September 19–22, 2017

Agenda Item 8

For:

☐ Approval

☒ Discussion

☐ Information

Public Sector Measurement

Project summary	Project will: revise IPSAS requirements for measurement and measurement-related disclosure; provide guidance on measurement; and, address the treatment of transaction costs, including borrowing costs, for measurement.	
	Topic	Agenda Item
Project management	1. Instructions—Up to September 2017 meeting	8.1.1
	2. Decisions—Up to September 2017 meeting	8.1.2
	3. Project roadmap	8.1.3
Education session	Measurement in the Conceptual Framework, IFRS 13, <i>Fair Value Measurement</i> , Government Finance Statistics (GFS) reporting guidelines and International Valuation Standards (IVS)	8.2.1
Decisions required at this meeting	Issue 1 Decision on options for broad approach	8.2.2
	Issue 2 Views on issues raised by IPSAS measurement of liabilities	8.2.3
	Issue 3 Valuation, transaction costs and borrowing costs	8.2.4
Supporting items	Advantages and disadvantages of Issue 1 options	8.3.1
	Chapter 7, <i>Measurement of Assets and Liabilities in Financial Statements</i>	8.3.2
	Summary of IFRS 13, <i>Fair Value Measurement</i>	8.3.3

IPSASB Instructions—June 2017 meeting and earlier

Meeting	Instructions	Actions
June 2017	<ol style="list-style-type: none"> 1. Consider convergence with IFRS, particularly scope to incorporate an IFRS 13, <i>Fair Value Measurement</i>, approach into IPSAS 2. Apply the Conceptual Framework's measurement objective to the treatment of transaction costs 3. For September 2017 IPSASB meeting: <ol style="list-style-type: none"> a) Bring back the transaction costs and borrowing costs issues as part of a more general discussion of asset valuation for the IPSASB's consideration; b) Provide education session on IFRS 13 and its post-implementation review; and c) Discuss ways to address fair value in IPSAS, in the context of the Conceptual Framework's approach to current value measurement and IFRS 13's approach. 	1-3 Done
March 2017	<ol style="list-style-type: none"> 1. Revise project brief and create project page 2. Develop a questionnaire for IPSASB/Technical Adviser/Observers' input on the project's scope 3. Identify project work streams 4 Provide education session on the IASB's post implementation review of IFRS 13 in September 5. Log information on how other IPSASB projects relate to the Public Sector Measurement project 	<p>1-3 Done</p> <p>4 For September</p> <p>5 In progress</p>
September 2015 to December 2016	Project awaits start. First discussion in March 2017	Done
June 2015	Revise project brief for IPSASB revisions.	Done

IPSASB Decisions—June 2017 meeting and earlier

Meeting	Decisions
June 2017	None
March 2017	Approved revisions to the project brief
September 2015 to December 2016	No decisions as project awaits start. First discussion will be in March 2017
June 2015	Approved the “Public Sector Measurement” project brief

PUBLIC SECTOR MEASUREMENT PROJECT ROADMAP

Meeting	Objective: IPSASB to consider:
March 2017	<ol style="list-style-type: none"> 1. Introduction to the project 2. Project objectives and timetable 3. Revised project brief
June 2017	<ol style="list-style-type: none"> 1. Preliminary analysis of IPSAS measurement requirements, including treatment of transaction costs
September 2017	<ol style="list-style-type: none"> 1. Preliminary analysis of measurement-related disclosure 2. Decisions on project next steps
<i>Indicative</i>	<i>Indicative</i>
December 2017	<ol style="list-style-type: none"> 1. Discuss ED, <i>Transaction Costs</i> 2. Discuss CP for measurement
March 2018	<ol style="list-style-type: none"> 1. Approve ED, <i>Transaction Costs</i> 2. Review draft chapters for CP, <i>Public Sector Measurement</i>
June 2018	Review draft chapters for CP, <i>Public Sector Measurement</i>
Sept 2018	Approve CP, <i>Public Sector Measurement</i>
Dec 2018	Review of responses to ED, <i>Transaction Costs</i>
March 2019	Issue IPSAS amendment, <i>Transaction Costs</i>
June 2019	Review of Responses to CP, <i>Public Sector Measurement</i>
Sept 2019	Review draft ED, <i>Public Sector Measurement</i>
Dec 2019	Approve ED, <i>Public Sector Measurement</i>
March 2020	Consultation Period
June 2020	
Sept 2020	Review of responses to ED
Dec 2020	Review draft pronouncement (and/or revisions to existing IPSASs)
March 2021	Issue pronouncement (and/or revisions to existing IPSASs)

Education Session

(PowerPoint slides for this Education Session will be provided separately.)

Background

1. The Education Session responds to IPSASB requests for:
 - (a) Information on the Conceptual Framework's Chapter 7, *Measurement of Assets and Liabilities in Financial Statements* (Chapter 7);
 - (b) An education session on IFRS 13, *Fair Value Measurement* (IFRS 13); and
 - (c) A description of measurement in GFS reporting guidelines and valuation guidance.

Detail*Conceptual Framework's Coverage of Measurement*

2. The presentation will highlight Chapter 7's:
 - (a) Measurement objective and measurement bases; and
 - (b) Reasons not to include "fair value" as a measurement basis.
3. Other relevant Conceptual Framework coverage will be noted. Chapter 7 is provided as agenda item 8.3.2.

IFRS 13, Fair Value Measurement

4. The session will then provide an overview of IFRS 13, *Fair Value Measurement*, including a comparison between the Conceptual Framework's approach to current value measurement and IFRS 13's approach. It will cover:
 - (a) Background to IFRS 13 and status of its post implementation review (PIR);
 - (b) Definition of fair value (exit price, not an entity-specific measure); and
 - (c) Fair value measurement framework, including its measurement techniques and hierarchy emphasizing observable measures:
5. A one page summary of IFRS 13 is provided as agenda paper 8.3.3.

GFS reporting guidelines and International Valuation Standards

6. There will also be an overview of measurement in Government Finance Statistics (GFS) reporting guidelines and International Valuation Standards (IVS), comparing their approach to measurement with those in the Conceptual Framework and IFRS 13. (Differences with respect to treatment of transaction costs are covered as part of [agenda item 8.2.4.](#))

No decision required

The education session supports the IPSASB's consideration of issues. No decisions are required.

1. Options to address Public Sector Specific Measurement in IPSAS

Questions

1. What are your views on:
 - (a) Options to address public sector measurement in IPSAS;
 - (b) How to identify when:
 - (i) A public sector specific measurement approach is needed, or
 - (ii) IFRS 13 may be applicable for IPSAS measurement?

Detail

1. In June, the IPSASB instructed staff and the Task Force to discuss ways to address fair value in IPSAS¹. The following four options were identified:
 - A Public sector specific IPSAS, *Measurement*, with little if any reference to IFRS 13;
 - B Hybrid IPSAS that applies the Conceptual Framework to public sector specific measurement issues and has a subsection to address areas where an IFRS 13 fair value approach could be applied;
 - C Hybrid IPSAS based on IFRS 13's measurement approach, with a subsection to address public sector specific measurement issues; and
 - D Converged IPSAS equivalent for IFRS 13, *Public Sector Measurement*².
2. Diagrammatically the different emphasis of each option can be represented as follows:



Task Force's Recommendation: Option B

3. The Task Force recommends Option B as the preferred option for further development. [Agenda item 8.3.1](#) provides the Task Force's views on advantages and disadvantages of each option.
4. Staff notes that, if the IPSASB approves this recommendation then the next step for Option B would be a review of IPSAS to identify where a public sector measurement approach is needed. That will indicate the relative size of public sector specific measurement coverage versus IFRS 13 coverage in the Hybrid IPSAS.

¹ The IPSASB also asked for information on the Conceptual Framework's Measurement chapter to explain the relationship between the Conceptual Framework's approach to current value measurement and IFRS 13's approach. This information will be provided as part of the Education session.

² IPSASB technical staff also discussed these options. They proposed a fifth option whereby two measurement IPSASs would be developed; an IPSAS focused on public sector specific measurement and a convergence IPSAS equivalent to IFRS 13. The Task Force decided against two separate measurement IPSASs.

Factor to Identify Public Sector Specific Measurement Needs

5. This project aims to improve IPSAS measurement, which includes improvements to reflect the Conceptual Framework, rather than attempt a fundamental reconsideration. Therefore the review of IPSASs (noted in paragraph 4 above) would identify where a public sector specific measurement approach already applies. Factors to consider include:
 - (a) Cases where IPSASs have already been adjusted to address public sector specific issues;
 - (b) Public sector specific IPSASs or situations, for example assets and liabilities that arise from a non-exchange transaction;
 - (c) Occurrence of public sector specific assets and liabilities, such as assets to provide services (or non-cash generating assets) and assets (or liabilities) for which neither a market value nor a meaningful net present value reflecting cashflows is available because the asset (or liability) is highly specialized and observable cashflows (if any) do not reflect the service potential or the service obligation involved.

Applicability of IFRS 13

6. The review of IPSASs would also consider scope to apply IFRS 13, *Fair Value Measurement*. Arguably the main factor to consider would be the extent to which IPSASs remain converged with those IFRSs that now apply IFRS 13.
7. IFRS 13 did not extend the use of fair value within IFRS. Furthermore, the IASB wanted to clarify the meaning of fair value without changing its meaning in IFRS. Therefore the IASB asked its technical staff to review all references to fair value in IFRS to gain assurance that the original use of fair value was consistent with an exit value. Applying the same logic, where measurement in a particular IPSAS remains converged with its equivalent IFRS it appears likely that an IFRS 13 approach to fair value would be appropriate.

Decisions required

The IPSASB is asked to:

1. Confirm that:
 - (a) The main options have been identified; and
 - (b) Option B is the option that Staff and the Task Force should develop.
2. Provide views on the factors used to identify when either:
 - (a) A public sector specific measurement approach is appropriate; or
 - (b) IFRS 13's fair value measurement framework may be applicable.

2. Measurement of Liabilities**Questions**

1. What public sector specific liability measurement issues need to be addressed by this project?
2. Where should a public sector specific approach be used for liability measurement?
3. Are there any IPSASs, situation or types of liabilities where the IFRS 13 approach to fair value measurement could be appropriate?

Detail*Conceptual Framework*

1. The Education Session noted that the Conceptual Framework identifies five measurement bases for liabilities: historical cost, cost of fulfillment, market value, cost of release, and assumption price. "Fair value" is not one of the measurement bases. The Conceptual Framework's definition of "market value" is the present IPSAS definition for fair value.

Liability Measurement in IPSASs

2. To support IPSASB consideration of when a public sector specific approach may be necessary for liability measurement, applying the approach outlined in Issue 1 (agenda item 8.2.2), those IPSASs that address liability measurement have been divided into two groups; the public sector specific Standards and IFRS convergence Standards:

Public Sector Specific

- IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*;
- IPSAS 32, *Service Concession Arrangements: Grantor*;
- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)*; and
- IPSAS 40, *Combinations*.

IFRS Converged

- IPSAS 13, *Leases*;
 - IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*;
 - IPSAS 29, *Financial Instruments Recognition and Measurement*, and
 - IPSAS 35, *Consolidated Financial Statements*;
 - IPSAS 37, *Joint Arrangements*; and
 - IPSAS 39 *Employee Benefits*.
3. Current and recent projects where liability measurement is relevant are; Social Benefits, Revenue and Non-Exchange Expenses, Leases, Financial Instruments (Public Sector Specific and Updates), Combinations, Employee Benefits, First-time Adoption of IPSASs, and Interests in Other Entities³.

³ Although the Heritage considers the potential for liabilities related to heritage items, liability measurement has not so far been a significant issue for this project.

4. In August, IPSASB staff provided their views on whether an IFRS 13 approach to fair value measurement would be appropriate in their current and recent projects⁴. Generally speaking they viewed an IFRS 13 approach for fair value as applicable. One exception was use of fair value in the context of revenue and non-exchange expenses, where further consideration is needed. For Social Benefits recent developments in favor of a “due and payable” recognition approach, means that the measurement of social benefit liabilities would be fairly straightforward if the resulting IPSAS takes that recognition approach.

Public Sector Specific Measurement Issues

5. In addition to application of the Conceptual Framework’s approach to measurement and consideration of scope to apply IFRS 13’s fair value measurement approach in IPSAS, other liability measurement issues identified through (a) IPSASB responses to the questionnaire⁵ and the Consultative Advisory Group discussion in June 2017 are:
 - (a) *General points*: Application of the Conceptual Framework and other factor to choose measurement bases; alignment with GFS reporting guidelines and valuation standards; guidance on use of historical cost, application of an IFRS 13 to measure fair value,
 - (b) *Use of market values*: Extent to which market values should be used in IPSAS in relation to public interest considerations. In particular, the use of current market rates of interest as discount rates for long-term liabilities such as pensions.
 - (c) *Guidance on discount rates*: How to identify appropriate discount rates, particularly when measuring long-lived liabilities like superannuation/pension liabilities, and how to address negative discount rates when measuring liabilities.
 - (d) *Management intention* when holding a liabilities; its significance for measurement of liabilities.
 - (e) *Cost-benefits*: Need for flexibility to apply a cost approach when the cost of fair value measurement outweighs the benefits.

Decisions required

The IPSASB is asked to provide direction on:

1. Public sector specific liability measurement issues that this project should address.
2. Those IPSASs, situations or types of liability where:
 - (a) A public sector measurement approach is needed; or
 - (b) An IFRS 13 approach to measurement could be applicable.

⁴ The External Reporting Board (XRB, New Zealand) and the Accounting Standards Board (ASB-South Africa) provided staff resources for the *Interests in Other Entities* and the First Time Adoption projects. The staff for those two projects have not yet been consulted on the extent to which an IFRS 13 fair value measurement approach could be appropriate in the resulting IPSASs.

⁵ The IPSASB received an analysis of questionnaire responses for its June 2017 meeting, agenda item 11.2

3. Asset Measurement, Transaction Costs and Borrowing Costs**Question**

1. Do you agree that the IPSAS treatment of transaction costs and borrowing costs could be improved by:
 - (a) Clarification of treatment of transaction costs across IPSASs, without changing established accounting treatment; and
 - (b) Removal of the option in IPSAS 5, *Borrowing Costs*, to capitalize certain borrowing costs as part of the initial cost to acquire an asset, so that all borrowing costs are expensed.

Detail

1. The discussion below responds to the IPSASB direction to:
 - (a) Bring back the transaction and borrowing costs issues as part of a more general discussion of asset valuation; and
 - (b) Apply the measurement objective to treatment of transaction costs.
2. This discussion aims to avoid repetition of coverage in the June issues paper, [agenda item 11.2](#). When discussing capitalization of borrowing costs it uses the phrase “certain costs” in reference to those borrowing costs for which IPSAS 5 allows the option of capitalization⁶.

Measurement of Assets

Availability of Measurement Bases—Financial Reporting, Valuation Standards and GFS

3. Financial reporting, including IPSAS and IFRS, uses a mixture of historical cost and current values to measure assets, depending on the situation and type of assets. The Conceptual Framework identifies historical cost and several current value measurement bases, including market value, for consideration. Its approach to selection of an appropriate measurement basis is described in paragraphs 6 and 7 below.
4. A valuer refers to the applicable Standard when valuing assets for financial reporting purposes. If the Standard has an option with respect to measurement basis, the client’s instructions will apply, others things being equal.
5. GFS reporting aims to value assets at current market prices⁷. Those national jurisdictions that align their public sector financial reporting with GFS reporting guidelines may encourage or require use of current market prices for asset measurement.

Selection of a Measurement Basis

6. The Conceptual Framework does not identify one, best measurement basis. It provides principles to select a measurement basis, as follows:

⁶ As explained in June, IPSAS 5 requires entities to expense all borrowing costs, with the exception of costs for a “qualifying asset” during the period between acquisition/construction and active use. A qualifying asset is one that takes a substantial period of time to get ready for use or sale. IPSAS 5 allows entities to capitalize borrowing costs in these circumstances. Expensing is the benchmark treatment.

⁷ See agenda item 1.7, GFS Tracking Table, which explains that “Current market prices are used for all flows, and stocks of assets/liabilities, but allowance is made for the use of alternative valuation methods where an active market does not exist.”

- (a) The objective of measurement: 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 purposes⁸.
 - (b) Need to evaluate the extent to which resulting information would achieve the qualitative characteristics, while taking into account the constraints.
 - (c) List of measurement bases that can be considered.
 - (d) Discussions of each measurement basis in terms of achievement of the measurement objective and the qualitative characteristics, while taking into account the constraints.
7. Chapter 7 also classifies measurement bases as either entry or exit, observable or unobservable and entity-specific or non-entity specific measures⁹. The discussion includes a statement that asset entry values reflect the “cost of purchase”. If transaction costs are viewed as part of the cost of purchase, then this indicates that they should be included when applying an entry value measurement basis, i.e. when applying historical cost, replacement cost or “market values in an open, active and orderly market” when that is an entry value.

Application of a Measurement Basis

8. Once a measurement basis has been identified, the question arises of how to apply that measurement basis. Issues include:
- (a) Historical cost:
 - (i) What is the accounting unit?
 - (ii) What costs should be capitalized as part of initial measurement?
 - (iii) How should depreciation (or amortization) be addressed (methods, useful life and residual value)?
 - (b) Current value:
 - (i) What type of current value measure should apply¹⁰?
 - (ii) How up-to-date (or how accurate) a current value is needed? (For example, how frequently should assets be revalued?)
 - (iii) Should imputed transaction costs be included in, for example, a replacement cost measure?
 - (iv) How do qualitative characteristics and the constraints apply when measuring assets on a current value basis?

Capitalization of Transaction Costs and Borrowing Costs

9. Accounting for transaction costs and borrowing costs on acquisition of an asset can be considered from the perspective of either recognition (i.e. whether such costs meet the definition

⁸ Paragraph 7.2, the Conceptual Framework.

⁹ Paragraphs 7.6-7.11, the Conceptual Framework.

¹⁰ IFRS 13 classifies this as a choice of measurement techniques (market, cost and income). However, note that the Conceptual Framework would not treat this question as a subsidiary issue of measurement basis application, but as a primary issue of measurement basis selection.

of an asset) or application of a measurement basis¹¹. This discussion focuses on measurement basis application. Present treatment in IPSAS, is as follows:

- (a) *Historical cost*: For historical cost the general rule has been that all costs directly attributable to an asset's acquisition should be included in its initial cost. Transaction costs fall within that rule by definition. Borrowing costs are open to debate. Arguably borrowing costs result from financing decisions rather than an asset's acquisition.
- (b) *Current value*: For current values the treatment of estimated transaction and borrowing costs could differ, depending on the type of current value measure. For example a replacement cost measure could, conceptually, include an estimate of transaction costs and possibly even borrowing costs¹².

Conceptual Framework and Cost Capitalization

- 10. The Conceptual Framework does not discuss application of measurement bases, only their selection. On the assumption that similar issues apply, one question would be the impact of accounting treatments on achievement of:
 - (a) A measure that fairly reflects the cost of services, operational capacity and financial capacity (the measurement objective); and
 - (b) The qualitative characteristics¹³.
- 11. If transaction costs and borrowing costs incorporate economic benefits and/or service potential then their capitalization should support achievement of an asset measure that fairly reflects the cost of services, operational capacity and financial capacity. However it is not clear that such costs do incorporate economic benefits and/or service potential.
- 12. A clear, consistent approach to the treatment of transaction costs and borrowing costs on initial measurement at cost will support the qualitative characteristics of comparability and understandability. In IPSAS scope for improvement exists for:
 - (a) Borrowing costs where entities presently have a choice between capitalization and expensing for certain costs; and
 - (b) Treatment of transaction costs, to the extent that IPSASs are presently unclear.

International Valuation Standards (IVS)—Treatment of transaction costs

- 13. IVS explain that most bases of value represent the estimated exchange price of an asset without regard to the seller's costs of sale or the buyer's costs of purchase and without adjustment for any taxes payable by either party as a direct result of the transaction. [210.1, IVS] This is consistent with IFRS 13's definition and guidance on measurement of fair value.
- 14. *Cost approach*: For the cost approach transaction costs may be included, when valuing assets. IVS states that the cost approach should capture all of the costs that would be incurred by a typical participant. [70.10., IVS] The list of costs to consider shows:
 - (a) Direct costs, such as materials and labour; and

¹¹ The relevance of asset recognition criteria to cost capitalization can be seen, for example, in IPSAS 17's treatment of "wasted items" i.e. costs that clearly do not "add value". Paragraph 36 states that "the cost of abnormal amounts of wasted material, labor, or other resources incurred in self-constructing an asset is not included in the cost of the asset." Such costs do not indicate future economic benefits or service potential.

¹² By contrast IFRS 13 defines fair value to generally exclude transaction costs.

¹³ Paragraph 7.4 of the Conceptual Framework.

- (b) Indirect costs, such as transport costs, installation costs, professional fees (design, permit, architectural, legal, etc.), other fees (commissions, etc.), overheads, taxes, finance costs (e.g., interest on debt financing), and profit margin/entrepreneurial profit to the creator of the asset (e.g. return to investors).
15. These costs include examples of transaction costs, for example legal fees, commissions and taxes. However, the fact that a valuer is expected to consider these costs when doing a cost approach valuation does not necessarily mean that all these costs will be included. For example, financial reporting standards do not usually treat a profit margin as appropriate for deriving the cost of an asset. As noted above, a valuer considers the purpose of a valuation and adjusts the valuation approach to ensure that it is fit for purpose given the relevant guidelines.

IVS—Treatment of Borrowing Costs

16. IVS explains that generally, the value of an asset is independent of how it is financed. However, in some circumstances the way items of plant and equipment are financed and the stability of that financing may need to be considered in valuation [90.1]. The examples that follow the general principle illustrate financing restrictions on an asset rather than the borrowing costs issue raised by IPSAS 5.
17. Borrowing costs are included in the list of costs for consideration when doing a “cost approach” valuation. Under indirect costs, there is an entry for “finance costs (e.g., interest on debt financing)”. Again, the fact that a valuer considers borrowing costs does not automatically mean that such costs will be included in the resulting valuation. That depends on the purpose of the valuation and the applicable guidance.

GFS Reporting Guidelines—Treatment of Transaction Costs and Borrowing Costs

18. Transactions costs are called “costs of ownership transfer” in GFS. They are:
- (a) Included in the cost of acquisition for nonfinancial assets; and
 - (b) Expensed for financial assets and liabilities¹⁴.
19. Borrowing costs are expensed.

Staff Recommendation: Remove option to capitalize borrowing costs

20. Staff recommends removal of the IPSAS 5 option that allows capitalization of certain borrowing costs. Staff’s view is that this would be an improvement resulting in better comparability and understandability. Further information on this recommendation is provided below.

IPSASB’s Initial Discussion—June 2017

21. The IPSASB’s June discussion indicated good support for a single treatment (i.e. removal of one of the options). Comments suggested more support for removal of IPSAS 5’s option to capitalize certain borrowing costs.

Borrowing Costs Issue: Background and Context

22. The Borrowing Costs issue first arose for the IPSASB as an IFRS convergence issue. The IASB removed the expense option in its equivalent Standard, requiring capitalization, in order to converge with the Financial Accounting Standards Board’s treatment, rather than for a compelling

¹⁴ Agenda item 1.7, GFS Tracking Table provides more detail relevant to this point. However, this summary captures the main points necessary for this general discussion of different approaches to asset valuation.

conceptual reason. Another significant benefit was that removal of options in IFRS improves the comparability and understandability of the resulting information.

23. In the public sector context debt financing is generally done centrally, without linkage to particular projects. The capitalization option may provide scope to add costs according to preparer preference. For example, if funding for a capital project is linked to the cost of the project, entities may decide to borrow especially for that project, so that they can show higher costs (and receive more funding) than would be the case without debt financing.
24. Arguments to expense borrowing costs (i.e. remove the capitalization option) are that this would:
 - (a) Better achieve the qualitative characteristics; and
 - (b) Be consistent with GFS reporting guidelines.
25. Arguments against this are that:
 - (a) This treatment would not be converged with IFRS (which requires capitalization); and
 - (b) Lack of IFRS convergence creates difficulties for “mixed group” situations where entities reporting on an IFRS basis are consolidated with those reporting on an IPSAS basis.

Project's Aim to Improve Measurement rather than make Fundamental Changes

26. The Public Sector Measurement Project aims to improve IPSAS measurement rather than carry out a fundamental review and rethink. Expected improvements include greater consistency with the Conceptual Framework and across IPSASs and greater clarity and understandability of existing measurement requirements in IPSAS. Staff view is that removal of one of the options in IPSAS 5 would be an improvement to IPSAS.
27. There is also scope, as discussed in the June issues paper ([agenda item 11.2](#)), to improve the clarity of existing treatment of transaction costs in IPSAS. As noted above, the Conceptual Framework does not provide guidelines on transaction costs in its discussion of measurement. Therefore a fundamental reconsideration of their treatment in IPSAS cannot be justified in terms of consistency with the Conceptual Framework. However greater clarity as to what IPSASs expect from preparers *vis a vis* the applicable treatment would support achievement of the qualitative characteristics, particularly comparability of information.

Decision required

The IPSASB is asked to provide direction on whether staff should draft IPSAS amendments to address:

- a) Clarification of treatment of transaction costs across IPSASs, without changing the present accounting treatment; and
- b) Removal of the option to capitalize certain borrowing costs in IPSAS 5, *Borrowing Costs*.

OPTIONS–PUBLIC SECTOR MEASUREMENT: ADVANTAGES AND DISADVANTAGES**A Public sector specific IPSAS, *Measurement****Advantages*

- Consistent with the Conceptual Framework
- Focuses on public sector measurement:
 - Suitable for public sector entities
 - Will address public sector specific measurement needs
- Addresses consistency of each IPSAS's measurement sections and a wider set of measurement issues (e.g. issues related to historical cost) than either Option C or Option D

Disadvantages

- Likely to take longer to develop (by comparison with the other three options)
- Could change a number of IPSASs
- Does not benefit from the work that the IASB did to develop IFRS 13
- Does not involve a comparison with IFRS and explanation for why specific measurement differences are necessary
- Reduces the understandability of terms across the two sectors (public and private)
- Could reduce users' ability to understand public sector financial reports and compare information between entities

B Hybrid IPSAS: Applies Conceptual Framework with IFRS 13 Subsection

As a hybrid, the advantages/ disadvantages are a mixture of those for A and D.

Advantages

- Similar advantages as for Option A:
 - Good consistency with the Conceptual Framework
 - Will address public sector specific measurement needs
 - Addresses consistency of IPSAS measurement sections and a wider set of measurement issues (e.g. issues related to historical cost) than either Option C or Option D
 - Benefits from the IPSASB's past work to identify (a) scope to converge with IFRS, and (b) areas where public sector specific differences are needed (at the standards level)
- Benefits from the work that the IASB did to develop IFRS 13
- Benefits from the IPSASB's past work to identify (a) scope to converge with IFRS, and (b) areas where public sector specific differences are needed (at the standards level)
- Increased understandability and comparability between the two sectors (public and private)

Disadvantages

- Need to include fair value as measurement basis, which is inconsistent with the Conceptual Framework

- Length of time may be longer than Options C and D
- The resulting IPSAS may be long and complex

C Hybrid IPSAS: Based on IFRS 13 with Public Sector Specific Measurement Subsection

As a hybrid, the advantages/ disadvantages are a mixture of those for A and D.

Advantages

- Time and cost effectiveness; relatively straightforward to develop
- Benefits from the work that the IASB did to develop IFRS 13
- Benefits from the IPSASB's past work to identify (a) scope to converge with IFRS, and (b) areas where public sector specific differences are needed (at the standards level)

Disadvantages

- Focus is on fair value, which is inconsistent with the Conceptual Framework
- Length of time likely to be longer than Option D
- May understate the need to address public sector specific measurement and therefore inadequately respond to those needs
- The resulting IPSAS may be long and complex

D IFRS 13 Converged IPSAS*Advantages:*

- Time and cost effectiveness; relatively straightforward to develop
- Will quickly address (a) areas where IFRS 13 measurement is appropriate (b) preparers' needs for guidance on appropriate measurement when applying IFRS-converged IPSASs that use fair value
- Benefits from the work that the IASB did to develop IFRS 13, including its private sector's testing

Disadvantages:

- Departs from the IPSASB's Conceptual Framework
- Likely to reduce the usefulness of information for accountability and decision making by users of the financial statements
- Will not address public sector specific measurement issues
- Does not benefit from previous IPSASB work to identify public sector specific differences in each IPSAS

CHAPTER 7: MEASUREMENT OF ASSETS AND LIABILITIES IN FINANCIAL STATEMENTS

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Introduction

- 7.1 This Chapter identifies the measurement concepts that guide the IPSASB in the selection of measurement bases for IPSASs and by preparers of financial statements in selecting measurement bases for assets and liabilities where there are no requirements in IPSASs.

The Objective of Measurement

- 7.2 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.

- 7.3 The selection of a measurement basis for assets and liabilities contributes to meeting the objectives of financial reporting in the public sector by providing information that enables users to assess:
- The cost of services provided in the period in historical or current terms;
 - Operational capacity—the capacity of the entity to support the provision of services in future periods through physical and other resources; and
 - Financial capacity—the capacity of the entity to fund its activities.
- 7.4 The selection of a measurement basis also includes an evaluation of the extent to which the information provided achieves the qualitative characteristics while taking into account the constraints on information in financial reports.

Measurement Bases and their Selection

- 7.5 It is not possible to identify a single measurement basis that best meets the measurement objective at a Conceptual Framework level. Therefore, the 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 assets and liabilities in order to meet the measurement objective.
- 7.6 The following measurement bases for assets are identified and discussed in terms of 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 the extent to which they provide information that meets the qualitative characteristics:
- Historical cost;
 - Market value;
 - Replacement cost;
 - Net selling price; and

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- Value in use.

Table 1 summarizes these measurement bases in terms of whether they (a) provide entry or exit values; (b) are observable in a market; and (c) whether or not they are entity-specific.⁸

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 ⁹	Unobservable	Entity-specific

7.7 The following measurement bases for liabilities 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 qualitative characteristics:

- Historical cost;
- Cost of fulfillment;
- Market value;
- Cost of release; and

⁸ 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.

⁹ As pointed out in paragraph 7.66, for non-cash-generating assets the calculation of value in use may require the use of replacement cost as surrogate.

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- Assumption price.

Table 2 summarizes these measurement bases in terms of whether they (a) provide entry or exit values; (b) are observable in a market; and (c) 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
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

7.8 Measurement bases may provide either entry or exit values. For assets, entry values reflect the cost of purchase. Historical cost and replacement cost are entry values. Exit values reflect the economic benefits from sale. An exit value also reflects the amount that will be derived from use of the asset. In a diversified economy entry and exit prices differ as entities typically:

- Acquire assets 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 on acquisition.

7.9 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.

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Observable and Unobservable Measures

- 7.10 Certain measures may be classified according to whether they are observable in an open, active and orderly market.¹⁰ 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

- 7.11 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 measure is taken by reference to the measurement objective and the qualitative characteristics.

Level of Aggregation or Disaggregation for Measurement

- 7.12 In order to present assets and liabilities in the financial statements in a way that provides information that best meets the measurement objective and achieves the qualitative characteristics 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.

Measurement Bases for Assets

Historical Cost

- 7.13 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.

- 7.14 Historical cost is an entry, entity-specific value.¹¹ 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,

¹⁰ The term “open, active and orderly markets” was developed by Dr. J. Alex Milburn. For example, see *Toward a Measurement Framework for Profit-oriented Entities*, published by the Canadian Institute of Chartered Accountants in 2012.

¹¹ The term “historical cost” may also be referred to as the “cost model” or generically as “cost-based measures.”

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as the service potential or ability to generate 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.

- 7.15 Under the historical cost model the amount of an asset may be reduced by recognizing impairments. Impairment is the extent to which the service potential or ability to generate economic benefits provided by an asset have diminished due to changes in economic or other 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

- 7.16 Where historical cost 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 when the assets are consumed. As the cost of services is reported using past prices, historical cost information will not facilitate the assessment of the future cost of providing services if cumulative price changes since acquisition are significant. Where budgets are prepared on the historical cost basis, historical cost information demonstrates the extent to which the budget has been executed.

Operational Capacity

- 7.17 If an asset has been acquired in an exchange transaction, historical cost 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.¹² 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 model. If an asset has been acquired in a non-exchange transaction the transaction price will not provide information on operating capacity.

¹² Where this is not the case the initial historical cost measurement will be reduced by the amount of the impairment.

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Financial Capacity

- 7.18 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 significantly different from current exit values.

Application of the Qualitative Characteristics

- 7.19 Paragraphs 7.16–7.18 explain 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 from the historical cost model 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 used in the historical cost model, particularly for non-cash-generating assets, can affect representational faithfulness. Because application of historical cost generally reflects resources consumed by reference to actual transactions, historical cost measures are verifiable, understandable and can be prepared on a timely basis.
- 7.20 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 in a meaningful way.
- 7.21 In certain circumstances the application of historical cost necessitates the use of allocations—for example where:
- Several assets are acquired in a single transaction;
 - Assets are constructed by the entity itself and overheads and other costs have to be attributed; and
 - The use of a flow assumption, such as first-in-first-out, is necessary when many similar assets are held. To the extent such allocations are arbitrary they reduce the extent to which the resulting measurement achieves the qualitative characteristics.

Current Value Measurements

- 7.22 Current value measurements reflect the economic environment prevailing at the reporting date.
- 7.23 There are four current value measurement bases for assets:
- Market value;

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

Market Value

7.24 Market value for assets is:

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

- 7.25 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.
- 7.26 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 7.28), 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 the ability to generate economic benefits by purchasing the same asset.
- 7.27 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 as that 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 Markets

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

- There are no barriers that prevent the entity from transacting in the market;
- They are active so there is sufficient frequency and volume of transactions to provide price information; and

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- 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 an orderly market as described.

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

- 7.29 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

- 7.30 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.
- 7.31 The use of market values permits a return on assets to be determined. However, public sector entities do not generally carry out activities 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.
- 7.32 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 expense related to changes in market value is more questionable.

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Operational Capacity

- 7.33 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 an exit-based market value is significantly lower than historical cost, market value is likely to be less relevant than the historical cost of such assets in providing information on operational capacity—such a market value is also likely to be less relevant than entry value-based current measures.

Financial Capacity

- 7.34 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

- 7.35 Values determined in open, active and orderly markets can be readily used for financial reporting purposes. The information will meet the qualitative characteristics—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.
- 7.36 The extent to which market values meet the qualitative characteristics 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

- 7.37 Replacement cost¹³ is:

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.

- 7.38 Replacement cost differs from market value because:

- In a public sector context it is explicitly an entry value that reflects the cost of replacing the service potential of an asset;
- It includes all the costs that would necessarily be incurred in the replacement of the service potential of an asset; and

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

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- It is entity specific and therefore reflects the economic position of the entity, rather than the position prevailing in 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.
- 7.39 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.
- 7.40 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.¹⁴ 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 reflect the difference in service potential between the existing and replacement asset.
- 7.41 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.
- 7.42 In some 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

- 7.43 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

¹⁴ There may be cases where replacement cost equates to reproduction cost. This is where the most economic way of replacing service potential is to reproduce the asset.

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sacrifice of service potential incurred by that use. That amount is its replacement cost—the entity is able to restore its position to that prevailing immediately before the consumption of the asset by an outlay equal to replacement cost.

- 7.44 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 (see also paragraph 7.48).

Operational Capacity

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

Financial Capacity

- 7.46 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

- 7.47 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 circumstances calculation of replacement cost is complex, and subjective judgments are required. These factors may reduce the representational faithfulness of replacement cost. In these circumstances the timeliness, comparability and verifiability of information prepared on a replacement cost basis may be affected, and replacement cost may be more costly than some alternatives. Replacement cost information may also not be straightforward to understand, particularly when that information reflects a reduction in required service capacity (see paragraph 7.41).
- 7.48 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-

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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

7.49 Net selling price is:

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

7.50 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 that it includes the entity's costs of sale. Net selling price therefore reflects constraints on sale. It is entity-specific.

7.51 The potential usefulness of measuring assets at 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 as a measurement basis 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.

7.52 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 the ability to generate 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

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

Operational Capacity

7.54 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

7.55 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

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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

- 7.56 As indicated in paragraph 7.52 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 may be made by reference to active markets where they exist. For major assets it may be possible and cost-effective to obtain professional appraisals. Net selling price will generally provide understandable information.
- 7.57 In most cases where net selling price is relevant, it will achieve the qualitative characteristics of faithful representation, verifiability, and timeliness.

Value in Use

- 7.58 Value in use is:

The present value to the entity of the asset's remaining service potential or ability to generate 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

- 7.59 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 7.42 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.
- 7.60 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.
- 7.61 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 service potential or ability to generate economic benefits is greater than its net selling price. In such circumstances value in use represents the value of the asset to the entity.
- 7.62 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.

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Costs of Services, Operational Capacity, Financial Capacity

- 7.63 Because of its potential complexity¹⁵, 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 generally 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

- 7.64 While value in use may be used in assessments of certain impairments its relevance for financial reporting purposes is limited to the circumstances outlined in paragraph 7.61.
- 7.65 The extent to which value in use meets the other qualitative characteristics 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.
- 7.66 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.
- 7.67 In the public sector, most assets are held with the primary objective of contributing to the provision of services, 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 may be inappropriate to calculate value in use on the basis of expected cash flows, because such a measure would not be faithfully representative of the value in use of such an asset to the entity. Therefore, it would be necessary to use replacement cost as a surrogate for financial reporting purposes.

¹⁵ See below paragraph 7.66

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

Measurement Bases for Liabilities

- 7.69 This section discusses the measurement bases for liabilities. This section does not repeat all the discussion in the section on assets. It considers the following measurement bases:

- Historical Cost;
- Cost of Fulfillment;
- Market Value;
- Cost of Release; and
- Assumption Price.

Historical Cost

- 7.70 Historical cost for a liability is:

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.

- 7.71 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.
- 7.72 Where the time value of a liability is material—for example, 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.
- 7.73 The advantages and drawbacks of using the historical cost basis for liabilities are similar to those that apply in relation to assets. 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.

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Cost of Fulfillment

7.74 Cost of fulfillment is:

The costs that the entity will incur in fulfilling the obligations represented by the liability, assuming that it does so in the least costly manner.

- 7.75 Where the cost of fulfillment depends on uncertain future events, all possible outcomes are taken into account in the estimated cost of fulfillment, which aims to reflect all those possible outcomes in an unbiased manner.
- 7.76 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.
- 7.77 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.
- 7.78 Where fulfillment will not take place for an extended period, the cash flows need to be discounted to reflect the value of the liability at the reporting date.
- 7.79 Cost of fulfillment is generally relevant for measuring liabilities except in the following circumstances:
- 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; and
 - In the case of liabilities assumed for a consideration, assumption price (see paragraphs 7.87-7.91) is more relevant when assumption price is higher than both cost of fulfillment and cost of release.

Market Value

7.80 Market value for liabilities is:

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

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- 7.81 The advantages and disadvantages of market value for liabilities are the same as those for assets. Such a measurement basis may be appropriate, for example, where the liability is attributable to changes in a specified rate, price or index quoted in an open, active and orderly market. 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, even if they exist, 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

- 7.82 “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 the creditor will accept in settlement of its claim, or 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.
- 7.83 For some liabilities, particularly in the public sector, transfer of a liability is not practically possible and cost of release will therefore be 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.
- 7.84 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.
- 7.85 In assessing whether cost of release is appropriate for measuring liabilities 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.
- 7.86 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 provides more relevant information than cost of release, even

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if it is feasible to negotiate a release from the obligation in accordance with the methods for transferring a liability in paragraph 7.84.

Assumption Price

- 7.87 “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.
- 7.88 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.
- 7.89 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.
- 7.90 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.
- 7.91 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 paragraph 7.42, replacement cost rather than value in use is the most relevant measurement basis.

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Basis for Conclusions

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

The Role of Measurement in the Conceptual Framework

BC7.1 The IPSASB decided that the initial focus of the Conceptual Framework 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* (the Consultation Paper), questioned this approach, the IPSASB considered that the original rationale for restricting the scope of this phase was sound and reaffirmed it.

The Objective of Measurement

BC7.2 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 qualitative characteristics. Accordingly, Exposure Draft, *Measurement of Assets and Liabilities in Financial Statements* (the Exposure Draft), proposed factors relevant to the selection of a measurement basis consistent with the objectives of financial reporting and the qualitative characteristics, but did not include a measurement objective.

BC7.3 Consistent with this approach the Exposure Draft proposed 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 is of 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 achieve the qualitative characteristics.

BC7.4 The Exposure Draft included an Alternative View 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 Alternative View considered that there is a risk that different and/or

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inappropriate measurement bases could be used to measure similar classes of assets and liabilities. The Alternative View 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.

- BC7.5 Many respondents, while generally in favor of the approach in the Exposure Draft, supported the Alternative View. The IPSASB also acknowledges 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 capital¹⁶. The IPSASB accepts that the operating capability concept is relevant and could be developed for public sector entities with a primary objective of delivering 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 discussed in paragraphs BC7.15-BC7.19, the IPSASB considers that historical cost measures often meet the measurement objective and therefore should be given appropriate emphasis in the Conceptual Framework.
- BC7.6 Subsequently 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 notes 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.
- BC7.7 The IPSASB considered whether the measurement objective proposed in the Alternative View 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

¹⁶ Such concepts of capital include invested money capital, current cash equivalents and operating capability.

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IPSASB therefore adopted the following measurement objective with only a minor modification from that proposed in the Alternative View:

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.

BC7.8 The IPSASB also notes that the disadvantages of using different measurement bases may be minimized by:

- 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
- 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

BC7.9 A measurement basis needs to be selected both when an asset or liability is recognized for the first time—initial measurement— and when it is reported in the financial statements of a later period—subsequent measurement. Some accounting policies are expressed in a way that may suggest that different principles apply to initial and subsequent measurement. For example, an asset may initially be recognized at transaction price and subsequently at a current value. The IPSASB therefore considered whether the Conceptual Framework should discuss initial and subsequent measurement separately.

BC7.10 One reason why different measurement bases may be specified for initial and subsequent measurement is that the basis to be used for subsequent measurement is not available at the time of initial measurement. 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 initial measurement 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 measurement 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 qualitative characteristics is an application of a measurement basis rather than a departure from it.

BC7.11 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

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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.

BC7.12 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

BC7.13 Measurement bases can be classified according to whether they provide an entry or exit perspective. As discussed in paragraph 7.8 entry values reflect the cost of purchase and exit values reflect either:

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

The IPSASB is of the view 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.

BC7.14 The IPSASB considered whether value in use should be classified as an entry value or an exit value. For a cash-generating asset value in use involves a discounted cash flow model using expected cash flows from the sale of good and services. For non-cash-generating assets value in use uses replacement cost as a surrogate—replacement cost is an entry value. This led some to express 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 acknowledges this view, but does not think that the use of replacement cost as a surrogate to calculate value in use means that value in use becomes an entry value. The IPSASB therefore concluded that value in use is an exit value for both cash-generating and non-cash-generating assets.

Measurement Bases for Assets

Historical Cost

BC7.15 Historical cost is a widely applied measurement basis in many jurisdictions. Many respondents to the Consultation Paper and the Exposure Draft advocated 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

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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.

- BC7.16. 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.
- BC7.17 The IPSASB agrees that, in many contexts, it is relevant to provide information on the transactions actually carried out by the entity, and accepts 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.
- BC7.18 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.
- BC7.19 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

- BC7.20 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 had been used extensively in IPSASB's literature. Many supporters of fair value

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considered that the definition should be an exit value as defined in International Financial Reporting Standards (IFRS).¹⁷

- BC7.21 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 users of financial statements. The IPSASB also noted that fair value in IFRS is explicitly an exit value—unlike the definition of fair value in the IPSASB's literature at the time the 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, in this chapter replacement cost is a measurement basis in its own right, rather than a valuation technique to determine fair value.
- BC7.22 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.
- BC7.23 In considering the merits of fair value 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.
- BC7.24 In finalizing the measurement chapter the IPSASB considered three main options in dealing with this issue:
- Adopt an exit value-based definition of fair value;
 - Retain the definition of fair value in IPSAS prior to the development of the Conceptual Framework; or
 - Include market value, rather than fair value, as a measurement basis as proposed in the Exposure Draft.
- BC7.25 Adopting an exit value-based definition of fair value would have meant using a definition that is not well aligned with the objectives of most public sector

¹⁷ IFRS 13, *Fair Value Measurement*, provides the definition of fair value.

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entities—the delivery of services rather than the generation of cash flows. It is questionable whether exit value-based measures would provide relevant information for many assets held for their operational capacity and for liabilities where it is not feasible to transfer the liability.

- BC7.26 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.
- BC7.27 The IPSASB acknowledged that not including fair value as a measurement basis would have implications for the IPSASB's extant literature at the time the Conceptual Framework was finalized, because a number of IPSAS's contained fair value in measurement requirements or options.
- BC7.28 On balance, the IPSASB concluded that, rather than include an exit value-based definition of fair value, or a public sector specific definition of fair value, the 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 may carry out further work at standards level to explain how the measurement bases in this chapter align with fair value, as implemented in IFRS.

Replacement Cost, Net Selling Price and Value in Use

- BC7.29 Because, the objective of public sector entities is to deliver services, often in non-exchange transactions, rather than to make profits 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 are 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.
- BC7.30 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.
- BC7.31 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

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

- BC7.32 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 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.
- BC7.33 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

- BC7.34 As indicated in paragraph BC7.20 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.
- BC7.35 A minority of respondents to the Exposure Draft supported the fair value measurement model. Some of these respondents thought that the IPSASB

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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 of these respondents 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 IFRS definition, while others 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

- BC7.36 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

- BC7.37 The Consultation Paper discussed the deprival value model as a rationale for selecting a current value basis. Some respondents expressed reservations—in particular that the model 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 overly complex. A view was also expressed that the deprival value model unduly exaggerates the qualitative characteristic of relevance and neglects the other qualitative characteristics.
- BC7.38 Although the IPSASB recognized that the deprival value model has been adopted successfully in some jurisdictions, the IPSASB acknowledged such reservations in whole or part. The IPSASB therefore 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 qualitative characteristics.
- BC7.39 Although 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—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

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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

- BC7.40 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 face of the statement of financial position when 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.
- BC7.41 The IPSASB acknowledges 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, because they do not provide relevant information on financial capacity, operational capacity or the cost of services. The majority of the IPSASB concluded that the decision whether to recognize an item as an asset should be made following an assessment of whether the item meets the definition of an asset and recognition criteria in Chapter 5, *Elements in Financial Statements*, and Chapter 6, *Recognition in Financial Statements*. 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.

Measurement Bases for Liabilities

Assumption Price and Cost of Release

- BC7.42 The IPSASB acknowledged the views of those who noted that, as 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 premiums following initial recognition.
- BC7.43 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

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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 assumption price and 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

BC7.44 The Consultation Paper sought the views of respondents on the following two issues related to measurement:

- The treatment of an entity's own credit risk and changes in value attributable to changes in an entity's own credit risk; and
- 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.

BC7.45 The majority of respondents who commented 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.

IFRS 13 Fair Value Measurements

Last updated: March 2017

SCOPE			DEFINITIONS
Applies when another IFRS requires/permits <i>fair value</i> (FV) measurements/disclosures.	Measurement and disclosure requirements do NOT apply to: <ul style="list-style-type: none"> Share-based payments (IFRS 2) Leases (IAS 17) Measurements similar to <i>FV</i> but not <i>FV</i> (e.g. net realizable value (IAS 2) or value in use (IAS 36)). 	Disclosure requirements do NOT apply to: <ul style="list-style-type: none"> Plan assets measured at <i>FV</i> (IAS 19) Retirement benefit plan investments (IAS 26). Assets for which recoverable amount is <i>FV</i> less costs of disposal (IAS 36). 	<ul style="list-style-type: none"> Fair value = price that would be received to sell an asset/paid to transfer liability in orderly transaction between market participants @ measurement date. Principal market = market with greatest volume and level of activity. Most advantageous market = market where highest profit. (price – transaction -transportation costs) Highest and best use = use of non-financial asset by market participants that would maximise value of asset/ group of assets and liabilities (e.g. a business) within which asset would be used.

FAIR VALUE MEASUREMENT APPROACH

A *FV* measurement requires an entity to determine the particular asset/liability subject to measurement, the valuation premise for a non-financial asset (if any), the *principal* or *most advantageous market* and the appropriate valuation technique(s).

THE ASSET OR LIABILITY	THE MARKET	VALUATION TECHNIQUES AND FAIR VALUE HIERARCHY	
<ul style="list-style-type: none">Take into account characteristics of asset/liability if relevant to market participants.<ul style="list-style-type: none">E.g. condition and location of asset and restrictions on sale or use of asset.Depending on <i>unit of account</i>, may be either as stand-alone asset/liability or group of assets and/or liabilities.<ul style="list-style-type: none">Unit of account = level at which asset or liability is aggregated or disaggregated in relevant IFRS for recognition purposes.	<ul style="list-style-type: none">Assume that transaction to sell asset/transfer liability takes place in:<ul style="list-style-type: none"><i>Principal market</i>; orONLY if no <i>principal market</i>, <i>most advantageous market</i>.Must have access to market @ measurement date.Need not undertake exhaustive search of all possible markets but shall consider ALL information that is reasonably available.In absence of information to the contrary, market where entity normally trades is presumed to be the principal market, or the most advantageous market.Even if no observable market @ measurement date, assume transaction takes place @ that date from perspective of market participant → assumed transaction establishes basis for estimating price.Price in market used to measure FV:<ul style="list-style-type: none">NOT adjusted for transaction costs (NOT characteristic of asset/liability).ADJUSTED for transport costs if location is a characteristic of the asset.	<p>Use valuation techniques appropriate in circumstances and for which sufficient data is available, maximizing the use of observable inputs (<i>Level 1</i>) and minimizing the use of unobservable inputs (<i>Level 3</i>).</p> <ul style="list-style-type: none">Use valuation technique consistent with one or more of the following approaches:<ul style="list-style-type: none">Market approach → uses prices and relevant information generated by market transactions involving identical/comparable assets and/or liabilities (individual or a group).Cost approach → reflects amount required currently to replace service capacity of asset.Income approach → converts future amounts (e.g. cash flows/income/expenses) to a single current (i.e., discounted) amount.Apply technique consistently unless change justified = change in accounting estimate (IAS 8).If transaction price is FV at initial recognition → calibrate valuation technique to be used in subsequent periods so that FV at initial recognition using valuation technique = transaction price.	<ul style="list-style-type: none">Inputs to valuation techniques must be categorized into one of three levels, as follows:<ul style="list-style-type: none">Level 1 = unadjusted quoted prices in active markets for identical assets/liabilities.Level 2 = inputs that are directly/indirectly observable for full term , other than those in Level 1. Includes:<ul style="list-style-type: none">Quoted prices for similar assets/liabilities in active markets.Quoted prices for identical/similar assets/liabilities in inactive markets.Inputs other than quoted prices that are observable for assets/liabilities (e.g. credit spreads, interest rates/yield curves, implied volatilities, etc.).Market-corroborated inputs (i.e., derived principally from/ corroborated by observable market data by correlation or other means).Level 3 = unobservable inputs.Where inputs to measure FV is categorized within different levels → categorize FV measurements in its entirety in the same level of the FV hierarchy as the lowest level input that is significant to entire measurement.

HIGHEST AND BEST (H&B) USE FOR NON-FINANCIAL ASSETS

- FV* measurement takes into account market participant's ability to generate economic benefits using the asset in its *H&B* use or by selling it to another market participant that would use it in its *H&B* use.
 - Considers the use that is physically possible, legally permissible and financial feasible, determined from the perspective of the market participant even if entity intends a different use (e.g. locks up to maintain competitive position).
 - However, entity's current use is presumed to be *H&B* use UNLESS market or other factors suggests a different use would maximize asset's value.
- FV* measurement assumes asset sold consistently with *unit of account* even if assumed that *H&B* use is to use asset in combination with other assets or other assets and liabilities.

This communication contains a general overview of this topic and is current as of March 31, 2017. The application of the principles addressed will depend upon the particular facts and circumstances of each individual case. Accordingly, this publication is not a substitute for professional advice and we recommend that any decisions you take about the application or not of any of the information presented be made in consultation with a qualified professional who can address any variance that may be required to reflect your circumstances. Please contact your local MNP representative for customized assistance with the application of this material. MNP LLP accepts no responsibility or liability for any loss related to any person's use or reliance upon this material. © MNP LLP 2017. All rights reserved.

FAIR VALUE MEASUREMENT APPROACH
MEASURING FV OF LIABILITIES AND ENTITY'S OWN EQUITY

- Assume liability/entity's own equity instrument is transferred to market participant @ measurement date and remains outstanding requiring the transferee to fulfill the obligation/take on the rights and responsibilities.
- Use quoted price, if available.
 - If quoted price not available but identical item held by another entity as asset → measure from perspective of market participant holding it @ measurement date.
 - If quoted price NOT available and identical item NOT held by another entity as asset → measure using valuation technique from perspective of market participant that owes liability/issued equity instrument.
- Take into account non-performance risk of liability (e.g. credit risk).
- Do NOT adjust for restriction preventing transfer of liability/equity instrument.

ADDITIONAL CONSIDERATIONS

- If asset/liability has a bid and ask price, use price within bid-ask spread that is most representative of *FV* in circumstances regardless where input is categorized in *FV* hierarchy.
- Election available for financial asset/liabilities with offsetting risk exposures to market/credit risks → measure based on net positions, if certain conditions are met.
- See IFRS 13 for circumstances where adjustments to Level 1 inputs are allowed.
 - If justified by *unit of account*, controlling/non-controlling interest adjustments are allowed.
 - No adjustment allowed for market that can't absorb entire holding.
 - IFRS 13 contains specific considerations when volume of transactions in market has significantly decreased or transactions are NOT orderly.