Exposure Draft 90

Amendments to IPAS as a result of the application of IPSAS 46 - Measurement

REQUEST FOR COMMENTS

European Accounting Association – Public Sector Accounting Committee (EAA PSAC)

In May 2024, the European Accounting Association (EAA) established the Public Sector Accounting Committee (PSAC) to strengthen the role of public sector accounting within the broader accounting field. The EAA PSAC's mission is to embed public sector accounting at the core of the accounting ecosystem by providing a nexus among academics, research networks, practitioners, and standard setters in the public sector accounting arena, to promote high-quality research, standard-setting, and public financial management and policymaking.

The EAA PSAC is committed to promoting and facilitating public sector accounting research; participating – also through ad-hoc task forces – in public consultation processes that are relevant to public sector accounting standard setting (e.g. IPSASB Exposure Drafts); networking with other accounting research groups and communities; and planning and organizing online activities and symposia at EAA conferences to discuss timely topics and stimulate debates between academics and practitioners. More information about the EAA PSAC is available at https://eaa-online.org/public-sector-accounting-2/.

In line with its mission, the EAA PSAC plans to involve public sector accounting scholars in drafting theoretically sound, research-based documents. These documents may be developed independently or in response to requests from bodies such as the IPSASB, providing theoretical insights and empirical evidence for consultation papers and exposure drafts. Importantly, the documents issued by the EAA PSAC reflect only the views of their signatories, not the collective perspective of the wider research community nor the opinions of the institutions affiliated with such signatories or of the European Accounting Association.

The EAA PSAC is currently chaired by Sandra Cohen (Athens University of Economics and Business, Greece), with Eugenio Anessi-Pessina (Università Cattolica del Sacro Cuore, Italy), Isabel Brusca (University of Zaragoza, Spain), Susana Jorge (University of Coimbra, Portugal), and Mariafrancesca Sicilia (University of Bergamo, Italy) as members.

Comments to ED 90

In April 2021, the International Public Sector Accounting Standards Board (IPSASB) issued two Exposure Drafts (EDs) to update its Conceptual Framework and to provide detailed guidance on the implementation of measurement bases. ED 76 amended the IPSASB's Conceptual Framework while ED 77 was codified as IPSAS 46, *Measurement*.

The *fil rouge* linking these documents was the need to align the Conceptual Framework with the suite of IPSAS and also to identify a clear set of measurement bases, which would contribute to meeting the objectives of financial reporting in the public sector.

To this end, IPSAS 46 established a measurement hierarchy organised on three levels: (i) measurement models; (ii) measurement bases; and (iii) measurement techniques. Historical cost and current value are measurement models. The former implies one measurement basis (historical cost), while the latter can be implemented through three bases, namely current operational value (only for assets), cost of fulfilment (only for liabilities), and fair value (for both assets and liabilities). These three bases, in turn, can be operationalised through different measurement techniques, namely market, cost, or income. Market or cost techniques can be applied to assess the value of assets under the current operational value basis. Income techniques can be applied to assess the value of liabilities under the cost of fulfilment basis. Market, cost, or income techniques can all be applied to assess the value of assets and liabilities under the fair value basis.

Having amended Chapter 7 of the Conceptual Framework and issued IPSAS 46, the IPSASB now needs to adapt existing standards to ensure consistency in the terminology used and in the underlying concepts, for example in IPSAS 45, *Property, Plant and Equipment* and IPSAS 41, *Financial Instruments*. More importantly, ED 90 aims to amend existing IPSAS to:

- "Add current operational value as an applicable current value measurement basis at initial and subsequent measurement for IPSAS 12, *Inventories*, and IPSAS 31, *Intangible Assets"*.
- "Update the definition of recoverable service amount in IPSAS 21, *Impairment of Non-Cash Generating Assets*".
- "Add a definition of accounting estimate to IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*".
- "Enhance the consistency of current value measurement to specific IPSAS".

To a large extent, therefore, all these amendments are the natural consequence of implementing the measurement project. In fact, some existing measurement bases, such as value in use and current replacement cost, are eliminated to pursue parsimony and internal consistency. According to the IPSASB, the removal of these bases is also intended to implement approaches that are believed to be more coherent with public-sector specificities. **The pursuit of parsimony, internal consistency, and coherence with public-sector specificities are all commendable goals, about which we agree. However, from both conceptual and**

practical perspectives, the amendments proposed by ED 90 raise several questions concerning the overall measurement project and its implications.

As mentioned, the IPSAS framework includes both the historical cost and the current value models. These two models differ in focus, orientation, reference basis, and timing (Biondi, 2012; Biondi and Oulasvirta, 2023) (see also Table 1). The current value model, which is centred around the balance sheet, reflects a static approach focused on assets and liabilities, from which the definitions of expenses and revenues are derived. It aims to assess the reporting entity's net worth at a specific point in time by measuring assets and liabilities at their current values, necessitating frequent re-measurements. Net worth is calculated as the difference between assets and liabilities, with income defined as the change in net worth between two points in time. As highlighted by Caruana (2021), the need for frequent re-measurements is problematic for at least two reasons: (i) it may compromise reporting reliability by introducing volatility into reported financial performance, and (ii) in the absence of active markets, it amplifies preparers' discretion, potentially leading to bias in financial reporting. In contrast, the historical cost model adopts a dynamic approach rooted in the revenue/expense view, where assets are linked to capital expenditures. This model is centred around the income statement, matching expenses with revenues and adhering to the realization principle whereby revenues are recognized primarily upon transactions with external parties. It provides a more reliable, objective, and less discretionary representation of financial performance, thus better meeting accountability needs.

Table 1. A summary of the current value and historical cost accounting models

Accounting models	**Current Value (static)**	**Historical Cost (dynamic)**
Orientation	Wealth	Income
Focus	Net worth of the reporting entity	Resource mobilized and utilized
Timing	Point in time; changes between points in time	Time period
Reference Basis	Properties and claims	Matching of expenses and revenues
Method	Stock method of accounting (asset-liability approach)	Flow method of accounting (revenue-expense approach)

Source: adapted from Biondi (2012) and Biondi and Oulasvirta (2023)

Scholars have also identified several additional reasons why the current value model is unsuitable for public sector entities (Anthony, 1978; Biondi, 2016; Biondi and Oulasvirta, 2023), as follows:

- Public sector assets are typically not held to generate cash flows through market sales. Thus, referring to current market values is often unnecessary unless an asset sale is imminent, or the asset is held for trading (Bond & Dent, 1998). Admittedly, this limitation has been partially overcome by the introduction of current operational value alongside fair value.

- The balance sheet focus of current value accounting does not align well with public sector financial management. For example, the fiscal strength of public entities is linked to sovereign powers, such as tax collection, which are not captured in balance sheets (Mautz, 1981; Caruana, 2021).
- Measuring and re-measuring all accounting elements at current values comes at high costs, which often exceed the relevant benefits (Ström, 1997; Ellwood and Greenwood, 2016).
- The current value model may shift policymakers' and managers' attention away from social and community value towards financial metrics. This shift may misalign with public sector priorities and potentially encourage undesirable decisions.
- The current value model increases complexity, for instance by including unrealized gains or losses as income or comprehensive income, potentially limiting citizens' and other relevant users' ability to comprehend financial statements, which can compromise democratic oversight.
- Implementing current value accounting often relies on the design and application of complex measurement techniques, potentially shifting influence and control from citizens and elected representatives toward technical experts.

In the literature, therefore, **the historical cost approach is often seen as preferable for public sector accounting** as it better aligns with the principles of accountable resource use, particularly for supporting and maintaining public service activities over time. Importantly, even historical cost cannot be uncritically transplanted from the private to the public sector. Rather, some adjustments are needed to fully address the unique characteristics of public sector entities. For example, the reverse matching method, which matches revenues to expenses, is generally considered more appropriate than the established (private-sector) approach of matching expenses to revenues (Anthony, 1978; Biondi and Oulasvirta, 2023). Significantly, a growing consensus exists about the need to establish an accounting theory that is specific to the public sector (Anthony, 1989; Pallot, 1992; Ellwood and Newberry, 2016; Steccolini, 2019; Anessi-Pessina et al., 2022). Recent discussions (e.g., Barbera et al., 2024; Bisogno et al., 2024; Cohen and Manes-Rossi, 2024) highlight the need for an accounting framework that considers not only the technicalities of accounting, but also its social implications.

Another critical issue with the current IPSAS approach, as confirmed in the measurement project, is the lack of commitment to a specific measurement model, which allows public sector entities to choose between historical cost and current value. Even more importantly, **no clear guidance has been issued on how to choose among the available measurement models and bases**. Without structured guidelines, accounting policy choices become highly subjective and may lead to inappropriate reporting practices, including "window dressing" opportunities where reported financial results are manipulated to pursue specific objectives. Comparability across public sector entities, which is one of the main objectives of IPSAS, may also be jeopardized, as national regulators may make diverging choices regarding the models and bases they allow and, within this regulatory framework, individual public sector entities may still be permitted to select from

several models and bases (Mattei et al., 2020; Polzer et al., 2021). Developing clear, tailored guidance could mitigate these risks, enhancing the reliability and comparability of public sector financial reports and improving accountability to citizens.

Finally, the introduction of **current operational value raises several concerns** (Task Force, 2021). A primary risk is that current operational value may unnecessarily inflate the reporting entity's current resource needs (i.e., current expenses to be covered by current revenues), even when the entity does not intend to replace the relevant assets in the near future. When replacement becomes necessary, the entity may rely on alternative funding sources, such as debt issuance, rather than operational cash flows or reserves. Current operational value thus raises concerns about intergenerational equity as it places an undue burden on current taxpayers, while future replacement could be funded through debt or other external sources, thus spreading costs across future taxpayers.

The concept of current operational value, moreover, probably requires some further refinement. Regarding right-of-use assets (Specific Matter for Comment-**SMC2**), in particular, the IPSASB reports having discussed whether current operational value could be used to subsequently measure these assets. Two views were articulated on this issue (ED 90, para. BC 98-100). The first view suggests that current operational value can be estimated by discounting cash flows using either the market or the cost approach. The second view posits that, in the absence of an income approach, current operational value has limited practical applicability. The Board ultimately supported the first view, reasoning that discounting cash flows "is a concept that is not limited to one measurement technique". From a conceptual standpoint, the very existence of these two views suggests that IPSAS 46 should be revised to better clarify the features and boundaries of the cost, market, and income approaches to the operationalization of current operational value.

ED90 also shows that the practical application of current operational value can be problematic, particularly for asset categories such as inventories, intangible assets, and right-of-use assets. To some extent, this is because the guidance provided in IPSAS 46 appears to be confined to the conceptual level, so practical difficulties may arise when such concepts are applied to specific asset types. For example, regarding **SMC 3**, it should be noted that the methods described in IPSAS 21 for value in use appear more helpful and practical than the guidance on current operational value in IPSAS 46. To another extent, it is because the reference to comparable assets is often hard to translate into practice. Regarding **SMC 2**, the two above-mentioned views on subsequent measurement both assume that entities should calculate the current operational value of right-of-use assets by discounting observable lease payments of comparable assets in an active market (ED 90, para. BC 99). However, accurately identifying and discounting cash flows for comparable assets in active markets is often complex, especially in the public sector, where active markets for many assets do not exist. Similar considerations seemingly hold for the application of current operational value to the subsequent measurement of intangible assets, as highlighted by the alternative view put forward by two Board members on **SMC 1** (AV1-9). Excessive discretion and subjectivity in accounting practices may ensue, opening the door to potential biases and reduced reliability and comparability in financial reporting.

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