CONCEPTUAL FRAMEWORK: MEASUREMENT OF ASSETS AND LIABILITIES IN FINANCIAL STATEMENTS

Objective(s) of Agenda Item

Material(s) Presented
- Agenda Item 2B.1 Issues Paper
- Agenda Item 2B.2 Revised version of CF–ED3

Background
2. This is a further version of CF–ED3. This version has been updated to reflect comments made by Board members on the version circulated on August 13th. A number of issues that staff have identified for discussion and decision is at Agenda Item 2B.1. The version at Agenda Item 2B.2 is a clean version. A mark-up showing changes from the August 13th version is available from staff on request. This revised version of CF–ED3 includes an Alternative View submitted by Ken Warren.

Action(s) Requested
3. The IPSASB is asked to consider the issues raised in the Issues Paper, review CF–ED3 and approve publication or provide directions for further development.
CONCEPTUAL FRAMEWORK: MEASUREMENT OF ASSETS AND LIABILITIES IN FINANCIAL STATEMENTS

ISSUES PAPER

Introduction

1. At its June 2012 meeting, the IPSASB reviewed a preliminary draft of Conceptual Framework Exposure Draft, Measurement of Assets and Liabilities in Financial Statements. The IPSASB made a number of directions for revision, including principally that:

   - Current Measurement Bases should be addressed in one section with sub-sections on market value, net selling price, replacement cost and a new sub-section on fair value, with the relocation of material in the Basis for Conclusions (BC) to the main body of the ED;

   - A more positive discussion of historical cost emphasizing that historical cost provides a direct link to transactions actually undertaken by the entity and therefore the actual cost of services. In many circumstances historical cost can be used to assess whether resources have been used economically and efficiently and to ensure that charges to “consumers” are based on actual costs incurred. Historical cost therefore meets the objective of accountability;

   - The relationship between the qualitative characteristics (QC) and the complexity and subjectivity involved in specific measurement bases should be clarified and it should be emphasized that complexity and subjectivity are not QCs; and

   - A simple matrix should be included indicating whether particular measurement bases adopt an entry or exit perspective and whether they are based on observable or non-observable market values.

2. As indicated at the June meeting the main involvement of Andrew Lennard, Director of Research at the United Kingdom Accounting Standards Board, ended at that meeting. The Coordinator has taken over the lead drafting responsibilities. Andrew has provided some guidance on the approach to restructuring and the Coordinator is very grateful for Andrew’s advice. Since the June meeting a revised version of the ED has been commented on by the Task Based Group (TBG) and a further version of the ED was then sent to the entire Board on August 13th. Staff is grateful to the TBG and to those who commented on the August 13th version.

3. Ken Warren has provided an Alternative View (AV) on the proposals in the ED. This is included in the revised version at Agenda Item 2B.2. Staff is very grateful to Ken for producing this AV in time for the meeting.

General Comments on Development of the Measurement Phase (Phase 3)

4. The approach to Phase 3 has gone through a number of modifications and Staff considers that it is worthwhile to provide a brief overview of how the approach to measurement has developed. The Consultation Paper, Measurement of Assets and Liabilities in Financial Statements (CF–CP3), was issued in December 2010. CF–CP3 adopted the view that it would not be expected that the Framework would identify a single measurement basis that is appropriate in all circumstances,
rather that different measurement bases should be selected in different circumstances to achieve an appropriate balance or trade-off between the QCs. A section of CF–CP3 specifically discussed the deprival value model as a method of selecting the most relevant measurement basis according to particular circumstances. Although it has been successfully used in some jurisdictions a number of respondents to CF–CP3 found the deprival value model over-complex and, following further deliberations, it was decided not to proceed with it.

5. Some respondents to CF–CP3 argued that the IPSASB should adopt a measurement basis based on an explicit measurement objective. Staff considered this view and proposed that the measurement objective should be based on current values. In making this recommendation staff explained that the adoption of a measurement objective based on current values would not preclude the use of historical cost for standards-setting purposes. The IPSASB accepted the view that there should be a measurement objective. However, although there was some support for the staff proposal, the IPSASB gave a direction that the measurement objective should be based on the objectives of financial reporting as specified in Phase 1.

Current Measurement Bases

Market Value and Fair Value

6. As indicated above, the individual sections on market value (previously current exchange value), replacement cost, and net selling price have been consolidated into a new section 3. In accordance with the direction at the June meeting this section also includes a new sub-section on fair value. This sub-section uses a considerable amount of material previously in the BC. Value in use continues to be addressed in a separate section on the grounds that its usage is limited (see below paragraph 13).

7. The rationale for a sub-section on fair value is that fair value is a widely used measurement basis in global standard setting. It is also used extensively in IPSASB’s current literature. A number of respondents to CF–CP3 commented that, because of these two factors, fair value should be considered explicitly in the Framework. At the Toronto meeting members agreed with this view.

8. Staff has very significant reservations about the incorporation of both market value and fair value in the body of the Framework. In the view of Staff the insertion of fair value unbalances the discussion, primarily because there is a considerable overlap with the section on market value. As highlighted in paragraph BC19 of the BC the definition of market value is virtually identical to the current definition of fair value in the IPSASB literature. It also does not differ significantly from the definition of fair value taken from IFRS 13, Fair Value Measurement, and quoted in paragraph 3.47.

9. Both the fair value and market value sub-sections deal with situations where there is not an open, active and orderly market (see below paragraph 25) and therefore where values have to be estimated. Staff acknowledges the rationale for including fair value in the body of the Framework, as its omission would have potentially far-reaching implications for IPSASB’s future standards-setting activities, particularly in respect of “alignment” projects, where approaches to the development of IPSASs are primarily drawn from IFRSs. This is because using a measurement basis in IPSASs that is not defined in the Framework would be highly problematic. However, the differences between market value and fair value are minor and including both bases in the Framework is confusing. Comments have been received from a member that supports this view.
member of the Advisory Panel has also commented that he does not understand the rationale for the inclusion of sections on both market value and fair value.

10. The ED makes the point that fair value is explicitly an exit value approach, which is the position adopted by the IASB in IFRS 13. It should also be noted that Application Guidance in IFRS 13 uses replacement cost in a different way to that currently in the ED. In the ED replacement cost is an entity-specific entry value, whereas in Application Guidance in IFRS 13 it is referred to as the cost approach and reflects the amount that “would be required currently to replace the service capacity of an asset.” As such, the cost approach is a method of determining a market-based exit value.

11. Staff considers that there are four options:
   - Retain the sections of the ED on market value and augment them with some material; from the fair value section. This section would be entitled “Fair Value”;
   - Use the same approach as in IFRS 13;
   - Use the same approach as in IFRS 13 except for exclusion of the cost approach (replacement cost) for the estimation of fair value under specified circumstances; or
   - Revert to the approach in version of the ED at the June meeting (subject to the use of the term “market values” rather than “current exchange values”) and re-locate the discussion of fair value in the Basis for Conclusions (BC). This would allow market value to be characterized as an observable exit value.

12. There are disadvantages with each of these options. Re-terming the existing sections on market value would mean that the term fair value would be used differently from that in the current IASB literature. This is likely to be confusing to users.

13. One approach to fair value is to adopt the same definition as that in IFRS 13. However, copying or interpreting a standards-level pronouncement of the IASB is not consistent with the stance that the Framework involves the development of concepts from first principles. Using the same approach as in IFRS 13 would also preclude the adoption of replacement cost as an entry value entity-specific measurement basis in its own right rather than as a valuation technique for estimating fair value.

14. Using the same definition and approach as in IFRS 13 except for the cost approach would allow replacement cost to be proposed as an entity-specific entry value. However, it would be an uneasy and potentially confusing compromise. Again, it is not consistent with the view that Framework should be developed from first principles.

15. As indicated above in paragraph 9, relocating the material in the BC would mean that fair value would not be discussed in the body of the ED and it will be questionable whether a measurement basis that is not included in the Framework should be used extensively at the standards level.

16. On balance, Staff favors dealing with fair value in the BC rather than proposing it as a measurement basis in the body of the ED. This would allow market value to be characterized as an observable exit value and would permit a more detailed analysis of IFRS 13 and the presentation of a conclusion why fair value has not been adopted in the Framework. The implication of this approach is that fair value will not be used as a measurement basis in new IPSASs and fair value as a term would be removed from existing standards, as they are reviewed following finalization of the Framework.
Value in Use
17. Although value in use is a current measurement basis it is addressed in a separate section (Section 4). The rationale for this is its complexity, the difficulty of applying what is basically a cash-based measurement basis in a public sector non-cash-generating context and its limited applicability to circumstances where an asset’s value is higher than net selling price but lower than replacement cost. Staff does not think that this rationale is very clear or persuasive. The fact that value in use can only be considered in the context of net selling price and replacement cost suggests that it should be in the same section as these two bases. Staff therefore agrees with a comment received on the revised August 13th draft that value in use should be included in the section on Current Measurement Bases rather than in a separate section.

Matter(s) for Consideration
1. Does IPSASB agree with the staff view that the inclusion of sub-sections on “Market Value” and “Fair Value” duplicates material?
2. Does IPSASB agree with the staff view that the material on fair value should be relocated to the Basis for Conclusions with the additions of explanatory material on why the IPSAB has decided not to adopt “fair value” as a measurement basis?
3. Does IPSASB agree that Section 4 on Value in Use should be relocated to Section 3: Current Measurement Bases?

Historical Cost
18. In accordance with the directions at the June meeting the discussion on historical cost has been modified and some of the references to historical cost that were perceived as inappropriately negative by some members have been deleted, e.g., the statement in paragraph 2.5 of the version on the agenda at the June 2012 meeting that “comparing the cost of services quantified at historical terms with taxes and other income in the period may also be misleading where price changes are significant as the latter are generally transactions of the current period and measured in current prices.”

Matter(s) for Consideration
4. Does IPSASB agree that Section 2 provides a balanced discussion of historical cost?

Relationship between Complexity and Subjectivity and the QCs
19. Some reservations were expressed at the June meeting that the use of complexity and subjectivity risked elevating these terms to the status of QCs. Staff considers that discussion of complexity and subjectivity is useful in facilitating an evaluation of the extent to which particular measurement bases meet the QCs. However, the use of sub-headings and the modification of the discussion indicates that complexity and subjectivity are not additional QCs.

Matter(s) for Consideration
5. Does IPSASB agree that the discussion of complexity and subjectivity is appropriate?
Matrix indicating Entry/Exit and Observable/Non-observable in Market

20. A matrix has been included that indicates whether current measurement bases reflect entry or exit values and are whether measurement bases rely on observations of an orderly, active and open market. This matrix was positioned at the end of Section 3, but following member comments has been re-located to the beginning of the section, so that it sets up the subsequent discussion. The description of the terms entry and exit value has been moved to Section 1, because they are also relevant to the discussion of historical cost.

Matter(s) for Consideration

6. Does the IPSASB agree with the content and location of the matrix indicating whether current value measurement bases embody entry or exit values and are reliant on observations in an open active and orderly market?

Other Issues

Measurement Bases and Information Needs

21. Paragraph 1.3 links the ED and Phase 1 by noting that service recipients and resource providers and their representatives are primary users of GPFRs and that the objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of GPFRs for accountability purposes and for decision-making purposes. It then identifies a number of information needs that are affected by selection of a measurement basis. These information needs are all drawn from Phase 1.

22. Paragraph 1.4 builds on this discussion by asserting that:

"A measurement basis contributes to meeting the information needs of users for accountability and decision-making purposes if it provides information on the following:

(a) The cost of services provided in the period, and in particular:
   (i) An appropriate comparison with the amount of taxes and other income received in the period; and
   (ii) Whether resources have been used economically and efficiently.
(b) Operational capacity: the resources available to provide services in future periods.
(c) Financial capacity: the capacity of the entity to continue to fund its activities, and meet financial claims on its resources; and financial flexibility: the capacity of the entity to adapt to changing circumstances."

23. Staff and TBG took the view that paragraph 1.4 adds little to paragraph 1.3 and that it is unclear why the information needs identified in paragraph 1.4 have been emphasized. Therefore, in the August 13th version the deletion of this paragraph was proposed. A comment was received supporting its retention and staff therefore decided to retain it for a Board view at this meeting.

Matter(s) for Consideration

7. Does the IPSASB consider that paragraph 1.4 in Section 1 should be retained?
Discussion of Proxy Values

24. A paragraph of the BC in the August 13\textsuperscript{th} version of the ED discussed the use of proxy values. It noted that cases arise where one measurement basis is regarded as the most appropriate conceptually, but for various reasons, another measurement bases may be used as a surrogate. The use of proxies is an application of rather than a departure from the Framework. Following comments received on the August 13\textsuperscript{th} version of the ED this discussion has been relocated to Section 1 in the body of the ED.

Matter(s) for Consideration

8. Does the IPSASB agree that a paragraph 1 on proxy values should be incorporated in the body of the ED?

Use of term “Open, Active and Orderly” Market

25. One of the responses to the August 27\textsuperscript{th} draft suggested that term “ideal market” should be replaced by the term “open, active and orderly” market. This term was developed by an accounting academic, Dr J. Alex Milburn. The rationale for this proposed change is that “ideal” is a normative rather than descriptive term. Staff considers that the term open, active and orderly is more informative and that a change is beneficial. Paragraph 3.6 explains that open, active and orderly markets exhibit the following characteristics:

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

Matter(s) for Consideration

9. Does the IPSASB agree that the term “open, active and orderly market” should be used rather than “ideal market?”

Deprival Value

26. CF–CP3 included a section on deprival value. As indicated above in paragraph 4 following consideration of the responses to CF–CP3 it was decided not to include deprival value in the ED as a method of selecting a measurement basis. Some of this material has been include in the Basis for Conclusions (paragraphs BC24–BC28) with an indication that some of the insights from the deprival value model have been reflected in the Framework.

Matter(s) for Consideration

10. Does the IPSASB agree that the discussion of deprival value in paragraphs BC24–BC28 is appropriate?

Table Comparing Assets and Liabilities Terminology

27. Section 5 includes a table that compares the terminology for assets and liabilities and indicates whether the measurement bases adopt an entry or exit perspective. By linking the measurement
bases for liabilities with those for assets the table sets up the subsequent discussion because the advantages and disadvantages of particular measurement bases mirror those in the sections on assets. In response to a staff request for views on the August 13th version a comment has been received that this table is unhelpful. Staff has kept it in the agenda version for this meeting, but requests a Board view on whether it should be retained.

**Matter(s) for Consideration**

11. Does the IPSASB consider that Table 2 in Section 5 should be retained?
Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities:
Chapter 6: Measurement of Assets and Liabilities in Financial Statements
This document was developed and approved by the International Public Sector Accounting Standards Board (IPSASB).

The IPSASB sets International Public Sector Accounting Standards (IPSASs) for use by public sector entities, including national, regional, and local governments, and related governmental agencies. A key part of the IPSASB’s strategy is to converge the IPSASs, to the extent appropriate, with the IFRSs issued by the IASB.

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

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

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REQUEST FOR COMMENTS

This Conceptual Framework Exposure Draft 3 (CF–ED3), *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Measurement of Assets and Liabilities in Financial Statements*, was developed and approved by the International Public Sector Accounting Standards Board (IPSASB).

The proposals in this Conceptual Framework Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by February 28, 2013.**

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

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

Guide for Respondents

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

Specific Matters for Comment

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

Specific Matter for Comment 1

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

Specific Matter for Comment 2

Do you agree with the current value measurement bases for assets that have been identified in Sections 3 and 4? If not, please indicate which additional measurement bases should be included or which measurement bases should not be included in the Framework?

Specific Matter for Comment 3

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

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

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

The Accrual Basis of Accounting

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

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

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

Project Development

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

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

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

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

The IASB has a project to update and refine its Conceptual Framework for profit-oriented entities. This project is currently deferred until the IASB concludes its ongoing deliberations about its future work plan.
Developments in the IASB’s Conceptual Framework are being monitored. However, development of the IPSASB’s Conceptual Framework is not an IFRS convergence project, and the purpose of the IPSASB’s project is not to interpret the application of the IASB Framework to the public sector.

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

**Consultation Papers and Exposure Drafts**

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

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

The project initially involved the development and issue for comment of Consultation Papers (CPs) that drew out key issues and explored the ways in which those issues could be dealt with. The CP for Phase 1 (The Objectives of Financial Reporting; The Scope of Financial Reporting; The Qualitative Characteristics of Information Included in General Purpose Financial Reports; The Reporting Entity), was issued in September 2008. CPs dealing with Phase 2 (Elements and Recognition in Financial Statements) and Phase 3 (Measurement of Assets and Liabilities in Financial Statements) were issued in December 2010 and a CP dealing with Phase 4 (Presentation in General Purpose Financial Reports) was issued in January 2012. Following consideration of responses to these CPs, EDs are developed for each of the phases. The ED for Phase 1 was issued in December 2010 and once finalized will become the first four chapters of the Conceptual Framework. This ED is the third in the series and once finalized will become Chapter 6 of the Conceptual Framework. The second ED on elements and recognition in financial statements was issued at the same time as this ED. An ED on Phase 4 is expected to be issued in 2013.

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1. The Role of Measurement in the Framework

Introduction

1.1 Accounting standards need to specify the assets and liabilities that are recognized in financial statements and how they are measured. This chapter provides guidance on (a) the measurement bases that need to be considered in developing International Public Sector Accounting Standards (IPSASs), and (b) by preparers of general purpose financial statements (hereafter, financial statements) in selecting measurement bases for assets and liabilities where there are no requirements in IPSASs. The Chapter is concerned solely with the measurement bases that may be used in financial statements, and not in other general purpose financial reports (GPFRs) outside the financial statements.

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

1.3 Chapter 2 of the Conceptual Framework identifies service recipients and resource providers and their representatives as primary users of GPFRs and states that “the objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of GPFRs for accountability purposes and for decision-making purposes.” It identifies a number of specific information needs of service recipients and resource providers and their representatives. The selection of a measurement basis affects assessments of the following:

(a) Liquidity and solvency;

(b) Financial capacity—the capacity of the entity to continue to fund its activities and meet its operational objectives in the future;

(c) Operational capacity—the physical and other resources available to support the provision of services in future periods;

(d) The capacity of the entity to adapt to changing circumstances;

(e) The cost of services provided in the period;

(f) Whether current levels of taxes and other income are sufficient to maintain the volume and quality of services currently provided; and

(g) Whether resources have been used economically and efficiently.

1.4 A measurement basis contributes to meeting the information needs of users for accountability and decision-making purposes if it provides information on the following:

(a) The cost of services provided in the period, and in particular:

(i) An appropriate comparison with the amount of taxes and other income received in the period; and

(ii) Whether resources have been used economically and efficiently.

(b) Operational capacity: the resources available to provide services in future periods.
(c) Financial capacity: the capacity of the entity to continue to fund its activities, and meet financial claims on its resources; and financial flexibility: the capacity of the entity to adapt to changing circumstances.

The relevance of a measurement basis may be assessed by considering the extent to which it provides information on the above factors.

**Qualitative Characteristics, Complexity and Subjectivity**

1.5 Chapter 3 of the Conceptual Framework identifies the qualitative characteristics (QCs) of information included in the GPFRs of public sector entities as: faithful representation; relevance; understandability; timeliness; comparability; and verifiability. It notes the pervasive constraints on information included in GPFRs of materiality, cost-benefit, and achieving an appropriate balance between the QCs.

1.6 In assessing the extent to which information prepared on a particular measurement basis meets the objectives of financial reporting and the QCs it is helpful to consider the complexity and subjectivity of that measurement basis. Complexity and subjectivity increase the risk of error. Therefore to the extent that a measurement basis requires complex and subjective calculations, it may be less representationally faithful and less verifiable. Greater complexity may also reduce understandability for the users of the financial statements, increase the costs of preparation and audit, and also have an adverse effect on timeliness. Subjectivity can reduce comparability between entities and thereby impair accountability, because different judgments may result in the same, or similar, assets and liabilities, being stated at different amounts. Subjectivity may also impair understandability, as the user may not have full information on the factors that have been reflected in the recognized amounts, although this risk may be partially mitigated by appropriate disclosures.

**Entry and Exit Values**

1.7 Measurement bases may use either entry or exit values. An entry value reflects the consideration payable by the reporting entity. Historical cost, considered in Section 2, is an entry value. An exit value reflects the amount that will be derived from the asset, either from its sale or its use. In a diversified economy entry and exit prices differ as entities typically acquire assets from specialized suppliers. The reporting entity cannot sell the asset at the same price as the party from which the asset was acquired, so the selling price of a recently acquired asset may differ significantly from the purchase price. This has implications for the selection of measurement bases in the public sector, because, as indicated in the Key Characteristics of the Public Sector with Potential Implications for Financial Reporting document (Key Characteristics), many of the assets deployed in the public sector, particularly property, plant and equipment are specialized. Such assets are needed to maintain the operational capacity of the entity. For such assets it is questionable whether exit values often provide relevant information that meets the objectives of financial reporting. In determining which current measurement bases are appropriate it is therefore important to consider whether a particular measurement basis reflects an entry or exit value.

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1 Issued in April 2011.
Possible Measurement Bases

1.8 It is not possible to select a single measurement basis for financial statements that will maximize the extent to which they meet the objectives of financial reporting and fulfill the QCs. This chapter does not therefore prescribe a single measurement basis (or combination of bases). It identifies the factors that are relevant in selecting a measurement basis for particular assets and liabilities in specific circumstances.

1.9 A number of possible measurement bases are discussed below. They are:

- Historical cost (Section 2);
- Market value (Section 3);
- Net selling price (Section 3);
- Replacement cost (Section 3);
- Fair value (Section 3); and
- Value in use (Section 4).

1.10 For each basis, the discussion initially addresses the extent to which that basis can provide relevant information for users on the items identified in paragraph 1.3 above in order to meet the objectives of financial reporting. The discussion then addresses the extent to which the measurement basis provides information that meets the other QCs. In assessing the extent to which a measurement basis meets the QCs there is an evaluation of complexity and subjectivity, as indicated above.

Use of Proxy Measurement Bases

1.11 There may be cases where one measurement basis is regarded as the most appropriate basis conceptually, but for various reasons another measurement bases may be used as a surrogate. A measurement basis might be selected as a proxy on cost-benefit grounds where it seems likely it will not usually differ materially from the measurement basis suggested by the discussion in this Chapter. The use of proxies is an application of rather than a departure from the Framework.

Liabilities

1.12 The principles that apply to the measurement of liabilities are the same as those that apply to assets. Section 5 addresses how similar bases may be applied to liabilities.

Comparisons with IASB Framework and Statistical Bases of Accounting

1.13 The Appendices include boxed comparisons with the International Accounting Standards Board’s (IASB) Framework and comparisons with Statistical Bases of Financial Reporting.
2. **Historical Cost**

2.1 Under the historical cost basis, assets are initially reported at the cost incurred on their acquisition, including transaction costs. Subsequent to initial recognition, this cost is allocated as an expense to reporting periods in the form of depreciation, as assets are consumed over their useful lives.

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

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

**Relevance of Historical Cost**

*Costs of Services*

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

*Operating Capacity*

2.5 The historical cost basis provides information on the resources available to provide services in future periods, based on their acquisition cost. At the time an asset is purchased, its value to the entity of this capacity to provide services can be assumed to be at least as great as the cost of purchase. As noted above, depreciation is recognized to reflect the extent to which the service potential or economic benefits of the asset have been consumed. If these mechanisms are effective, it can be expected that historical cost information will ensure that the resources available for future services are at least as valuable as the amount at which they are stated. However, under the historical cost basis increases in value are not reflected. Therefore, on the basis of historical cost information, it is not possible to judge the extent to which the value of resources available to provide future services exceeds the recognized amount.

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2 The cost of an asset is modified for depreciation and impairment in order to reflect carrying amount. Depreciation reflects the consumption of an asset rather than a reduction in value due to economic conditions.

3 Where this is not the case the initial historical cost measurement will be reduced by the amount of the impairment.
Financial Capacity and Financial Flexibility

2.6 The amount at which assets are stated in financial statements assists in an assessment of financial capacity and financial flexibility. It can provide information on the amount of assets that may be used as security for borrowings. Effective security depends on the ability of the lender to realize value through sale of the asset. An assessment of financial flexibility 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. Hence when historical cost is used in the financial statements there is a case for supplementary disclosure of selling prices.

Application of the Qualitative Characteristics

2.7 Application of historical cost often involves little complexity and subjectivity, because transaction information is usually readily available, and because impairment is the exception rather than the rule. As a result amounts derived on a historical cost basis are generally representationally faithful in that they represent what they purport to represent—that is, the historical cost of the asset. Estimates of impairment can be complex, particularly for non-cash-generating assets, which can affect representational faithfulness. Because application of historical cost provides an indication of resources consumed by reference to actual transactions historical cost measures are verifiable, understandable and can be prepared on a timely basis.

2.8 Although the simplicity and objectivity of historical cost contribute to comparability, information is comparable only to the extent that prices at the time of acquisition are similar. Because historical cost does not reflect the impact of price changes, it is not possible to compare the amounts of assets that were acquired at different times when prices differed. This difficulty arises when comparing the financial statements of entities that hold or consume assets acquired at different times as well as comparing items within the financial statements of the reporting entity. There can also be circumstances where historical cost does not provide relevant information; for example when there is no transaction price and where estimating a transaction price is not feasible.

2.9 Complexity and subjectivity can arise in the application of historical cost. In some circumstances it is necessary to use allocations, for example, (a) where several assets are acquired in a single transaction, (b) where assets are constructed by the entity itself and overheads and other costs have to be attributed and, (c), the use of a flow assumption, such as first-in-first-out (“FIFO”) where many similar assets are held. To the extent such allocations are subjective or arbitrary they reduce the extent to which the resulting measurement fulfills the QCs.

Application of Historical Cost

In meeting the objectives of financial reporting and providing information that meets user needs historical cost is an appropriate measurement basis for many assets held for use in an entity's operations, especially where price changes are unlikely to be significant during the period for which the asset is held by the entity. Examples: some inventories that are consumed within a short time of purchase; items of property, plant and equipment.
3. **Current Value Measurement Bases**

3.1 This section outlines a number of current measurement bases and places particular emphasis on whether these bases are entry or exit values. These current measurement bases are:

- Market value;
- Replacement cost;
- Net selling price; and
- Fair value.

Although value in use is also a current measurement basis it is discussed separately in Section 4, because it is strongly linked to replacement cost and net selling price and provides relevant information in limited circumstances.

3.2 The following table summarizes the above measurement bases in terms of whether they use either entry or exit values and whether values are derived from observation of an orderly, active and open market.

<table>
<thead>
<tr>
<th>Measurement Basis</th>
<th>Entry or Exit</th>
<th>Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market (but with costs of purchase deducted)</td>
<td>Entry</td>
<td>Observable</td>
</tr>
<tr>
<td>Replacement cost</td>
<td>Entry</td>
<td>Unobservable</td>
</tr>
<tr>
<td>Market in an open, active and orderly context.</td>
<td>Entry and Exit</td>
<td>Observable</td>
</tr>
<tr>
<td>Market (but with costs of sale deducted)</td>
<td>Exit</td>
<td>Observable</td>
</tr>
<tr>
<td>Net selling price</td>
<td>Exit</td>
<td>Observable</td>
</tr>
<tr>
<td>Fair value</td>
<td>Exit but entry used as a surrogate in some cases)</td>
<td>Unobservable</td>
</tr>
</tbody>
</table>

**Market Value**

3.3 A "market value" is defined as:

“The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction at the reporting date.”

3.4 It should be noted that at acquisition market value and historical cost will be the same. The extent to which market value meets the objectives of financial reporting and the information needs of users varies depending upon the relevance of market prices to the assessments being made on the quality of the market evidence. Market evidence, in turn, depends upon the characteristics of the market in which the asset is traded. Market value is particularly appropriate where the asset is being held for sale and where it is judged that the difference between entry and exit values is unlikely to be significant.
3.5 The following paragraphs discuss three kinds of market values that differ depending on the quality of the market evidence and assesses the extent to which these market values meet the QCs:

- Market values in open, active and orderly markets;
- Estimated market values; and
- Notional market values.

**Market Values in Open, Active and Orderly Markets**

3.6 Open, active and orderly markets exhibit the following characteristics:

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

Such markets deal in assets that are identical and therefore mutually interchangeable, such as commodities, currencies and securities where prices are publicly available. In practice few, if any, markets fully exhibit all of these characteristics, but some may approach this description. 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.

3.7 Values in open, active and orderly markets can be readily used for financial reporting purposes. There is little or no complexity or subjectivity, and the information will meet the QCs: that is it will be relevant, representationally faithful, understandable, comparable and verifiable. Under such market conditions entry and exit values can be assumed to be the same or very similar. Because it can be prepared quickly, such information is also likely to be timely. However, the extent to which the information reflecting market values meet the QCs will decrease as the quality of market evidence decreases.

3.8 Information based on market values can be expected to be highly comparable, both within and between entities, as similar assets will be stated at similar amounts.

**Market Values where there are not Open, Active and Orderly Markets**

3.9 Where an open, active and orderly market, or a close approximation to it, does not exist market participants will incur costs. Market values therefore may be either entry or exit. Entry values reflect the costs of purchase and exit values reflect the costs of sale. The following subsections address approaches to ascertaining market value where there is not an open, active and orderly market.

**Estimated Market Values**

3.10 In the absence of current price information from open, active and orderly markets, it is possible to use estimated market values where market prices for similar, but not identical, assets are available. For example, an unquoted investment might be valued by reference to prices for similar quoted

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4 The term “open, active and orderly markets” was developed by Dr J. Alex Milburn.
Investments, adjusted to reflect any relevant differences, such as the lower liquidity associated with an unquoted investment. Where such estimated market prices are used, the extent to which the information exhibits the QCs will be reduced. However, the use of such prices may have the advantage of treating similar assets consistently (e.g., quoted and unquoted investments) and thereby be more comparable.

3.11 Estimated market values may involve complex and subjective adjustments to observable market prices. This reduces representational faithfulness, comparability and verifiability, particularly where estimated market values are derived from mathematical models. The use of such models is likely to diminish understandability as the user of the information may not appreciate or even be aware of the assumptions in the models and the limitations of the models. For example, an estimated market value may be adjusted to take into account the reduced liquidity of an asset. However, this does not mean that the asset could be sold for that amount: a forced sale would result in a lower value.

**Notional Market Values**

3.12 In some circumstances there is little information on the market value of an asset. This is often the case in the public sector where assets that are held to provide services would have little or no value to another party without significant adaptation for different operational requirements.

3.13 A realistic appraisal of the exit value of such an asset would usually attribute a low value to it. This is because any prospective purchaser would have to bear the cost of adapting the asset to an alternative use. A prison, for example, might be constructed at a considerable cost but a valuation based on selling price would reflect only the value of the land and, unless the building could be adapted to an alternative use, be reduced by the cost of demolition. The use of exit prices/values for such assets is unlikely to provide relevant information, as the entity is unlikely to dispose of an asset that it requires in order to fulfill its service objectives. Such an exit value would not be representationally faithful of the value of the asset to the entity. The entity could obtain the services provided by the asset only by incurring a cost that is greater than that exit value, as assets such as prisons will rarely if ever be available in a market, and the entity would need to construct the asset or adapt an existing asset to maintain its operating capacity. Furthermore, reducing the recognized amount of a newly constructed asset to its market price would result in a reported loss, which would not provide representationally faithful information on the financial performance of the entity.

3.14 It is possible to prescribe that, for such assets, the relevant market value is that which would be obtained in the case of a sale to a purchaser who can use the asset in the same manner as the current owner and, for example, owns any necessary complementary assets. However, these assumptions are unlikely to reflect reality, as many of the assets used by public sector entities in providing services would not be used by other entities. Thus this approach risks not meeting the QC of relevance.

**Relevance of Market Values**

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

3.16 The relevance of market values, however, is more questionable when it cannot be assumed that the asset may be sold for the same price at which it can be acquired. 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 because of factors related to operational capacity the value to the entity may be greater. Hence market values may not reflect the value to the entity of the asset represented by its operating capacity.

Costs of Services

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

3.18 It can be argued that the use of market values permits the comparison of the amount received on sale of an asset with its current market value and/or current market revenue generated from the services provided by an asset with the current market value of that portion of the asset consumed in producing those services, and thus shows the extent to which the entity has obtained a superior return to that which is implicit in current market prices. However, this argument is generally less convincing in the public sector than in the private sector. Public sector activities are not generally carried out with the primary objective of generating profits, and services are often provided without charge or on subsidized terms so there is little relevance in comparing the reported return to that implicit in market prices.

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

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

Operating Capacity

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

3.22 As noted above (see paragraphs 1.4 and 2.6), an assessment of financial capacity and financial flexibility requires information on the amount that would be received on sale of an asset. This information is provided by exit prices. Therefore entry-based market values are not relevant to an assessment of financial capacity and financial flexibility.

Applying Market Value

In meeting the objectives of financial reporting and providing information that meets user needs, market value is an appropriate measurement basis for assets that are quoted on active orderly and open markets, and that may be disposed of without affecting the operations of the entity.

Examples: quoted securities, investment properties.

Replacement Cost

3.23 The replacement cost of an asset 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.”

3.24 Replacement cost differs from market value in the following ways:

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

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

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

3.27 The appropriate service potential is that which the entity is capable of using, having regard to the need to hold service capacity to enable the entity to deal with contingencies that might arise. This
results in the reduction of the replacement cost of an asset when the need for its service capacity falls. 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.

Relevance of Replacement Cost

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

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

Costs of Services

3.30 Replacement cost provides a relevant measure of the cost of the provision of services. The cost of consuming an asset is equivalent to the amount of the sacrifice incurred by that use. The loss incurred by using an asset is its replacement cost: the entity is able (if it is so desired) to restore its position to that prevailing immediately before the consumption of the asset by an outlay equal to replacement cost. Put another way, the economic decrement caused by consumption of an asset is its replacement cost.

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

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

3.33 It is possible to combine historical cost and replacement cost information by reporting separately the extent to which changes in prices are reflected in the costs reported in the year.\footnote{It would also be possible to adopt the same approach to combine historical cost and market value.} These amounts are sometimes referred to as “realized holding gains.” This permits the financial
CONCEPTUAL FRAMEWORK FOR GENERAL-purpose FINANCIAL REPORTING BY PUBLIC SECTOR ENTITIES: MEASUREMENT OF ASSETS AND LIABILITIES IN FINANCIAL STATEMENTS

statements to report both (a) the costs based on previous cash flows, as well as (b) the costs based on current resource use. Both sets of information may be useful to an assessment of accountability, and of future resource needs.

Operating Capacity

3.34 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 and Financial Flexibility

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

Application of the Qualitative Characteristics

3.36 In some cases calculation of replacement cost is complex, and subjective judgments are required. This may make the measurement of replacement cost less representationally faithful. Replacement cost information may also not be straightforward to understand, particularly when that information reflects a reduction in required service potential as discussed in paragraph 3.28. Such cases also prejudice the timeliness, comparability and verifiability of information prepared on a replacement cost basis, and will also make it more costly than some alternatives.

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

Application of Replacement Cost

In meeting the objectives of financial reporting and providing information that meets user needs replacement cost is an appropriate measurement basis only for assets that will be used in the provision of services and for which replacement cost is readily obtainable.

Examples: buildings such as prisons, schools and hospitals. Inventories such as commodities that are subject to significant price changes during the period for which they are held.

Net Selling Price

3.38 “Net selling price” is defined as:
“The amount that the entity can obtain from sale of the asset at the reporting date, after deducting the costs of sale.”

3.39 Net selling price differs from market value in that it is explicit that it is sale. Its application does not require an orderly, active and open market. Net selling price would therefore reflect constraints on sale.

Relevance of Net Selling Price

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

3.41 Net selling price is therefore relevant where the most resource-efficient course available to the entity is to sell the asset. This is the case where the asset cannot provide service potential or economic benefits at least as valuable as net selling price.

Costs of Services

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

Operating Capacity

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

Financial Capacity and Financial Flexibility

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

Application of the Qualitative Characteristics

3.45 Assessments of net selling price may be subjective, but will often not be highly complex. For major assets it may be possible and cost-effective to obtain professional appraisals. For other assets, it may be clear that net selling price is so low that it will not be materially different from a nominal amount or nil.

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6 “Net selling price” is similar to the concept of “fair value less costs to sell” used currently in IPSASs.
3.46 It would seem likely that in most cases where net selling price is relevant, it will be adequately representationally faithful, verifiable and capable of being produced in timely manner. It will also generally be understandable and comparable.

Application of Net Selling Price

In meeting the objectives of financial reporting and providing information that meets user needs net selling price is an appropriate measurement basis only for assets that are not capable of yielding service potential or economic benefits if they continue to be held and therefore can only be sold.

Examples: plant that has reached the end of its useful life; obsolete buildings that cannot be used by the entity; certain types of inventory that are in excess of the needs of the entity.

Fair Value

3.47 “Fair value” is:

“The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.”

3.48 The objective of a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or would take place between market participants at the measurement date under current market conditions. Factors involved in fair value measurement include:

(a) For a non-financial asset, the valuation premise that is appropriate for the measurement (consistent with its highest and best use).

(b) Determination of the principal (or most advantageous) market for the asset or liability.

(c) The valuation technique(s) appropriate for the measurement, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the asset or liability.

3.49 Fair value draws on many of the considerations that have been discussed in the subsection on market value. However, fair value differs from market value in that it is explicitly an exit value: it uses the price that would be received on sale of an asset. The relevant price is that prevailing in a transaction with another market participant. Unlike net selling price fair value is not adjusted to reflect transaction costs—that is, the costs that would be incurred if the asset were to be sold. Although, as noted, fair value is an exit value the operationalization of this concept includes the use of input prices as surrogates when exit prices are not readily available.

3.50 The determination of a fair value measurement involves a three level hierarchy:

- **Level 1** inputs are quoted prices in active markets for identical assets that the entity can access at the measurement date. Because level one inputs are based on active markets, which come close to the open, active and orderly market considered in the market value subsection above.

- **Level 2** inputs are variables other than quoted market prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

- **Level 3** inputs are unobservable inputs for the asset or liability.

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7 The definition of fair value is that in IFRS 13, *Fair Value Measurement* issued by IASB in May 2011.
Relevance of Fair Value

3.51 The fact that fair value is explicitly an exit value limits its relevance in the public sector. It is relevant for certain financial assets, particularly those held to be traded or for sale, where there are highly active and liquid markets and therefore transaction costs are immaterial and can be ignored without impairing representational faithfulness. Conversely, where assets are specialized and differences in entry and exit prices are therefore significant it is of more limited relevance. Where an asset will provide service potential or other economic benefits that are greater than its exit price, exit values do not provide is not the most relevant measurement basis. Where the most resource efficient course is to sell the asset (because the service potential or economic benefits that it will provide is not as great as can be received from sale), the most relevant measurement basis is likely to be net selling price, and the amount of the asset should be reduced to reflect the costs of sale (see above paragraph 3.39).

3.52 Fair value can provide a relevant basis for assessing a financial return. Where assets are stated at fair value, financial performance can be assessed in the context of the return implicit in market values. However, public sector activities are not generally carried out with a view to obtaining a financial return, so the relevance of assessing any such return in the context of a market setting is reduced.

Costs of Services, Operating Capacity, Financial Capacity and Financial Flexibility

3.53 Because it is an exit value the usefulness of fair value for determining the cost of services and for assessing operating capacity is limited. Because it is an exit price is relevant to assessments of financial capacity and financial flexibility. However, the fact that, at Level 3, the hierarchy does involve unobservable inputs does need to be taken into account. The reasons mirror those in the analysis of net selling price in paragraphs 3.39–3.47.

Application of the Qualitative Characteristics

3.54 Where fair value is based on Level 1 inputs involving quoted prices for active markets for identical assets or liabilities there is little or no complexity and subjectivity. As the volume and quality of data available from orderly, active and open markets diminishes and Level 2 and 3 inputs have to be used the level of complexity increases. Particularly for Level 3 inputs such complexity can lead to doubts about the faithful representation of the values derived from models and can also have an adverse impact on understandability and verifiability. Whereas values based on quoted and active markets for identical assets and, to a lesser extent, similar assets can be produced in a timely manner those based on mathematical models may not be timely and can be costly.

Application of Fair Value

In meeting the objectives of financial reporting and providing information that meets user needs fair value is an appropriate measurement basis relevant for certain financial assets, where there are highly active and liquid markets, and where transaction costs are immaterial.

Examples: financial assets held to be traded or for sale and investment properties.
4. **Value in Use**

4.1 “Value in use” is defined as:

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

**Relevance of Value in Use**

4.2 Value in use is an exit value as it reflects the amount that can be derived from an asset through its operation and its disposal at the end of its useful life. As noted in paragraph 3.30 above, the value of an asset’s service potential is often greater than its replacement cost. (It is also usually greater than its historical cost.) Where this is the case, reporting an asset at its value in use would have little relevance, as by definition, the entity is able to secure equivalent service potential at replacement cost. For this reason, value in use is mainly used for impaired assets, that is, assets where the amount of the remaining service potential or economic benefits is less than the carrying amount, which reflects historical cost, or replacement cost. An alternative approach to value in use in such cases is to revise the estimate of the asset’s remaining service potential or economic benefits and hence its replacement cost.

4.3 Value in use is also not a relevant 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.

4.4 Thus value in use is only relevant where it is less than replacement cost and greater than net selling price. This occurs where an asset is not worth replacing, but the value of its economic benefits or service potential is greater than its net selling price. In such circumstances value in use represents the value of the asset to the entity.

4.5 Because value in use has a role in financial reporting only in conjunction with other measurement bases, there is no benefit in assessing the relevance of information prepared wholly on the basis for value in use for specific purposes.

**Application of the Qualitative Characteristics**

4.6 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.

4.7 In practice, 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.

4.8 In the public sector, most assets contribute to the provision of services in non-exchange transactions rather than to the generation of profits: such assets are referred to as “non-cash-generating assets.” Because it is a cash-based concept operationalizing value in use in such a context is even more problematic. It is inappropriate to calculate value in use on the basis of cash generated for such assets. It is therefore necessary to use replacement cost as a proxy.
4.9 The calculation of value in use is therefore complex and subjective, even in relatively straightforward cases. This complexity and subjectivity reduces the representational faithfulness of value in use. It also prejudices the timeliness, comparability and verifiability of information prepared on a value in use basis.

Costs of Services, Operating Capacity, Financial Capacity and Financial Flexibility

4.10 Because of its complexity, its limited applicability and the fact that its operationalization in a public sector context is likely to involve the use of replacement cost as a proxy value in use is inappropriate for determining the cost of services. Its relevance to assessments of operating capacity, is limited and is only likely to be significant in the atypical circumstances identified in paragraph 4.4 where entities have a large number of assets that are not worth replacing, but the value of their economic benefits or service potential 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 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 makes its relevance to assessments of financial capacity and financial flexibility highly limited.

<table>
<thead>
<tr>
<th>Application of Value in Use</th>
</tr>
</thead>
<tbody>
<tr>
<td>In meeting the objectives of financial reporting and providing information that meets user needs value in use is an appropriate measurement basis for assets that will continue to yield service potential but which would not merit replacement. These are generally assets that would not recover their carrying amount unless written down to value in use. Examples: assets where the service potential, or economic benefits, has been impaired due to price changes or decrease in demand for their services. Assets that continue to provide cost savings, but would command only a negligible value if sold and cannot be replaced.</td>
</tr>
</tbody>
</table>
5. **Measurement Bases for Liabilities**

5.1 This section reviews the measurement bases discussed in the earlier sections of this Chapter in the context of liabilities. As stated in paragraph 1.7, the principles that apply to the measurement of liabilities are the same as those that apply to assets. However, the significance of certain issues differs, and the terminology that is appropriate for assets needs to be adapted.

5.2 The measurement bases for assets, the corresponding terminology for liabilities and whether a basis is an entry or exit value is set out below.

**Table 2: Measurement Bases and Corresponding Asset Terminology for Liabilities**

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Entry or Exit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Historical cost</td>
<td>Historical cost</td>
<td>Entry</td>
</tr>
<tr>
<td>Market value</td>
<td>Market value</td>
<td>Entry or Exit</td>
</tr>
<tr>
<td>Net selling price</td>
<td>Cost of release</td>
<td>Exit</td>
</tr>
<tr>
<td>Replacement cost</td>
<td>Assumption price</td>
<td>Entry</td>
</tr>
<tr>
<td>Value in use</td>
<td>Cost of fulfillment</td>
<td>Exit</td>
</tr>
</tbody>
</table>

**Historical Cost**

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

5.4 Where the time value of a liability is material (that is, where the length of time before settlement falls due is significant), the amount of the future payment is discounted so that, at the time a liability is first recognized, it represents the value of the amount received. The discount is amortized over the life of the liability, with the result that the liability is stated at the amount of the required payment when it falls due.

5.5 The advantages and drawbacks of using the historical cost basis for liabilities are similar to those that apply in relation to assets (see Section 2). However, historical cost cannot be applied for liabilities that do not arise from a transaction, such as a liability to pay damages for a tort or civil damages. It is also difficult to apply historical cost to liabilities that may vary in amount, such as those related to defined benefit pension liabilities.

**Market Value**

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

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

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

5.9 In some cases there may be evidence of the price at which liabilities 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 of the entity continues to exist and should continue to be recognized. The arrangement may, however, result in a separate asset of the entity for rights established against the other party. For example, if an entity has an obligation under a lease to restore a property and pays a contractor to carry out the necessary work, payment gives rise to a right against the contractor, not a transfer of the liability (unless the lessor agrees to release the liability and obtains rights directly against the contractor).

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

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

Assumption Price

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

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

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

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

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

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

Cost of Fulfillment

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

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

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

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

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

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

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

5.25 Cost of fulfillment is generally relevant except in the following circumstances:

(a) Where the entity can obtain release from an obligation at a lower amount than cost of fulfillment, then cost of release is a more relevant measure of the current burden of a liability. (Just as, for an asset, net selling price is more relevant when it is higher than value in use.)

(b) In the case of liabilities assumed for a consideration, assumption price is more relevant when assumption price is higher than both cost of fulfillment and cost of release.
Basis for Conclusions

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

The Role of Measurement in the Framework

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

BC2. In December 2010, the IPSASB published a Consultation Paper, Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Measurement of Assets and Liabilities in Financial Statements (CF–CP3). This Exposure Draft has been developed after further deliberations by the IPSASB, including consideration of the responses received to CF–CP3.

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

BC4. Some respondents, while supporting the general approach in CF–CP3, suggested that the selection of a measurement basis should be guided by a single measurement objective, such as providing the value to the entity at the reporting date. The IPSASB decided not to pursue this approach as it might unduly restrict the choice of measurement bases. The IPSASB decided that specifying an overall measurement objective related to a measurement basis would lead to the risk of the measurement objective competing with, rather than complementing, the overall objectives of financial reporting and the QCs. Accordingly, the Framework relates the factors relevant to the selection of a measurement basis to the objectives of financial reporting specified in Chapter 2 of the Framework and the QCs specified in Chapter 3.

BC5. The IPSASB noted that the disadvantages of using different measurement bases may be minimized by:

(a) Selecting different measurement bases only where this is justified by economic circumstances, thereby ensuring that assets and liabilities are reported on the same basis where circumstances are similar; and

(b) Requiring transparent presentation and disclosure to ensure that the measurement bases used and the amounts reported on each basis are clear.
Possible Measurement Bases

BC6. The Chapter aims to be complete by discussing the measurement bases that need to be considered in the development of an IPSAS and the selection of an accounting policy by preparers in the absence of an IPSAS. The measurement bases that are addressed in this Chapter include those that are often used in practice or advocated in theory.

BC7. CF–CP3 discussed a range of measurement bases. It considered the attributes/usefulness of: historical cost; market value and replacement cost. In addition, it considered value in use and net selling price in the context of the deprival value model. Respondents to CF–CP3 generally agreed that these were the most relevant bases. Some respondents suggested that fair value should also be discussed. The IPSASB agreed that the Framework should discuss all of these measurement bases outlined in CF–CP3, as well as fair value in the Framework. Fair value is discussed further in paragraphs BC21–BC26 below. The IPSASB considered whether to use the term “current exchange value” rather than “market value” to clarify that a current exchange value can be derived where market evidence is not available. However, the IPSASB decided that, although it can be ambiguous in a public sector context, “market value” is a widely used and understood term and it is appropriate to use it in the Framework.

BC8. The Chapter aims to provide useful guidance for the selection of a measurement basis but it does not aim to be determinative. In many circumstances it will remain a matter of judgment as to which measurement basis most effectively meets the objectives of financial reporting, satisfies users’ information needs and secures the best balance between the QCs.

Use of Proxy Measurement Bases

BC9. The IPSASB acknowledged that there may be cases where one measurement basis is regarded as the most appropriate basis conceptually, but for various reasons another measurement bases may be used as a surrogate. For example, a measurement basis may be well established for use for statistical purposes or by the valuation or actuarial profession: that basis might be selected as a proxy on the grounds of cost-benefit where it seems likely it will not usually differ materially from the measurement basis suggested by the discussion in this Chapter. The IPSASB concluded that the appropriate use of proxies is an application of rather than a departure from the Framework.

Initial and Subsequent Measurement

BC10. 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 Chapter should discuss initial and subsequent measurement separately.

BC11. One reason why different measurement bases may be specified for initial and subsequent recognition is that the basis to be used for subsequent recognition is not available at the time of initial recognition. This is particularly common in the public sector where assets are sometimes contributed, or provided on subsidized terms, or in exchange for other non-cash assets. In such a case the value of the transaction may be unknown, and if the asset is to be
subsequently accounted for at an entry value such as historical cost or replacement cost, another basis has to be specified for use on initial recognition as a proxy for the amount at which the asset would be stated if purchased on arm’s-length terms. Proxies may also be required for the initial recognition of assets acquired before the introduction of accrual accounting where the transaction price is not known. As stated above, the sensible use of proxies is an application of a measurement basis rather than a departure from it.

BC12. Another reason for an apparent difference in initial and subsequent recognition arises where an asset is to be accounted for at a current value, and the transaction price is deemed to reflect the particular current measurement basis that will be used. In such a case, specifying that the asset is to be initially recognised at transaction price makes it clear that that application of the policy will not result in the recognition of revenue on initial recognition (“day one” gains or losses). In principle, the same measurement basis is used for both initial and subsequent recognition: the requirements for each are specified differently in order to assist understanding.

BC13. The IPSASB concluded that, in principle, the same considerations apply to initial and subsequent recognition. Accordingly the discussion in this Chapter is applicable to both situations.
Section 2: Historical Cost

BC14. Historical cost is a widely applied measurement basis that is firmly embedded in the financial reporting of the public sector in many jurisdictions. Many respondents to CF–CP3 supported the continued widespread use of historical cost as a measurement basis, mostly in combination with other measurement bases. They supported this view by reference to the simplicity and verifiability of historical cost. Supporters of historical cost also consider that the link between historical cost and the transactions actually undertaken by the entity is particularly important for an assessment of accountability. They also noted that, because historical cost is widely used under current practice, its continued use avoids the costs that would arise if a standard were to require the use of a different measurement basis.

BC15. The IPSASB agreed that historical cost is generally understandable and verifiable and that where it is used under current practice, a change to another measurement basis should be required only where it is judged that the benefits of doing so outweigh the costs of change.

BC16. Some respondents considered that historical cost information provides a highly relevant basis for the reporting of the cost of services. The IPSASB agreed that, in many contexts, it is relevant to provide information on the transactions actually carried out by the entity because users are particularly interested in the cost of services based on actual transactions. Because 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 promote fairness to consumers of service. However, another approach to assessing and reporting the cost of providing services is the value that has been sacrificed in order to provide those services. 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. It is important that the Framework acknowledges both these perspectives.

BC17. Some respondents agreed with the suggestion made in CF–CP3 that the use of historical cost facilitated a comparison of the actual results and the approved budget. The IPSASB acknowledges that budgets may often in practice be prepared on a historical cost basis and that where this is the case historical cost enhances comparison against budget. It is noted that budgets may also reflect anticipated prices during a period.
Section 3: Current Value Measurement Bases and Section 4: Value in Use

Market Values

BC18. CF–CP3 discussed “market value” as a possible measurement basis. As indicated above, the IPSASB considered using the term “current exchange value” instead of market value, in order to indicate that the discussion addresses both the circumstances where the asset in question is traded on an orderly, active and liquid market and circumstances where market values have to be estimated because observable market evidence is either limited or unavailable.

BC19. The definition of “market value” is the same (with the addition of “at the reporting date”) to the term “fair value” as that term is used in current IPSASs.

BC20. The Chapter provides a discussion of market value as it and similar concepts are used in accounting standards and it is likely that this will continue for some time. That discussion enables similarities with and differences from other measurement bases to be highlighted and is therefore helpful in providing a complete and unbiased discussion of measurement bases.

Replacement Cost and Net Selling Price in the Context of Value in Use

BC21. CF–CP3 discussed the deprival value model (sometimes referred to as the “value to the entity” model). The deprival value model can be used to select the most relevant basis in specific circumstances. It can require consideration of up to three measurement bases—replacement cost, value in use and net selling price. The deprival value model is based on the premise that the value of an asset to an entity (that is, its deprival value) reflects the loss that the entity would sustain if it were deprived of the asset. This may also be stated as the amount that the entity would rationally pay to acquire the asset, if it did not already own it.

BC22. The value of an asset to the entity cannot be higher than replacement cost as, by definition, the entity is capable of obtaining equivalent service potential (including the net amount that would be received on disposal of the asset) by incurring a cost equivalent to replacement cost. However, if that service potential is not as great as replacement cost, recoverable amount is the relevant measure.

BC23. Recoverable amount is usually defined as the greater of value in use and net selling price. However, as value in use includes the net amount that will be received on disposal, net selling price can be seen as a limiting case of value in use, which is when the value of the remaining service potential is nil.

Deprival Value

BC24. The decision process used in the deprival value model can be depicted diagrammatically as follows:
Respondents to CF–CP3 expressed some concern about the use of the deprival value model. In particular, respondents felt it would be costly, and impose a disproportionate burden on preparers, to have to consider three possible measurement bases for each asset that is reported. A number of respondents also expressed a view that it is over complex.

While the IPSASB acknowledged that the deprival value model has been adopted successfully in some jurisdictions, the IPSASB concluded that it would not usually be practicable for an accounting standard simply to require the use of the deprival value model. However, some insights of the model are reflected in the Framework, which states that:

(a) Net selling price is clearly relevant when the most resource-efficient use of the asset is to sell it (paragraph 3.42), but is not relevant for assets, where the service potential to be derived from the asset is more valuable (paragraph 3.41).

(b) Replacement cost is not relevant where it is greater than recoverable amount (paragraph 3.42).

(c) Value in use is relevant only where it is less than replacement cost and greater than net selling price (paragraph 4.4).

The IPSASB noted that the deprival value model addresses only the relevance of particular measurement bases and that the objectives of financial reporting and the other qualitative characteristics also are also significant considerations in the selection of a measurement basis. For example, where the deprival value model suggests that replacement cost is the most relevant basis, historical cost may be preferred because of the emphasis placed on the accountability that a reliance on actual transactions provides and its simplicity and verifiability.

The IPSASB also noted that, where assets are traded on a deep and liquid market to which the reporting entity has access, a market value may be consistent with the deprival value model as, subject to transaction costs, the market value will equal current replacement cost and net selling price.

**Fair Value**

CF–CP3 did not discuss fair value. A number of respondents pointed out that fair value is a measurement basis that is defined and used in specifying measurement requirements by
many global and national standard setters and that fair value has been used extensively in IPSASB’s existing literature. They further highlighted that, although the pronouncement does not form part of its Conceptual Framework project, the IASB issued IFRS 13, *Fair Value Measurement*, in May 2011 and suggested the Conceptual Framework should include discussion of fair value as a potential measurement basis in the Conceptual Framework.

**BC30.** The IPSASB noted that fair value, as defined in IFRS 13 is explicitly an exit value and that therefore relevance of fair value in the public sector is likely to be limited to meeting the objective of reporting on financial capacity, rather than on providing a measure of the cost of services and operating capacity. The IPSASB also noted that some of the other current value measurement bases discussed in CF–CP3 overlapped with concepts used in IFRS 13. For example, replacement cost (referred to as the cost approach in IFRS 13) is used as a valuation technique in IFRS 13 to estimate fair value. In the context of IFRS 13 replacement cost is used as a surrogate for exit value.

**BC31.** In the public sector many assets are specialized and differences in entry and exit prices are therefore significant. Where an asset will provide service potential or other economic benefits that are greater than its exit price, a measure reflecting exit values is not the most relevant basis. Where the most resource efficient course is to sell the asset (because the service potential or economic benefits that it will provide is not as great as can be received from sale, the most relevant measurement basis is likely to be net selling price, which reflects the costs of sale).

**BC32.** In considering the merits of fair value (as used in IFRS 13) as a measurement basis, the IPSASB accepted that fair value provides a relevant basis for assessing a financial return. Where assets are stated at fair value, financial performance can be assessed against in the context of the return implicit in market values. However, public sector activities are not generally carried out with a view to obtaining a financial return, so the relevance of assessing any such return in the context of a market setting seems slight.

**BC33.** While noting that the relevance of fair value in the public sector is limited, on balance the IPSASB took the view that fair value should be addressed in the Conceptual Framework because of its important and entrenched status in global standard setting.
Section 5: Measurement Bases for Liabilities

BC34. The IPSASB considered whether the relief value model, which is an adaption of the deprival value model for liabilities, provided valuable insights into the measurement of liabilities in a public sector context and decided to include a discussion of the model in CF–CP3, which explained the application of measurement bases to liabilities as well as assets.

BC35. While few of the respondents to CF–CP3 addressed the issue of liabilities the IPSASB concluded that the principles of measurement that apply to assets are equally applicable to liabilities. The discussion in Section 5 adapts the terminology and seeks to explain the necessary differences of emphasis. The IPSASB noted that, because, as highlighted in Key Characteristics, many goods and services are provided by public sector entities in non-exchange transactions there will not be an assumption price. Furthermore, there is unlikely to be a cost of release, because the creditor is unlikely to accept a sum lower than cost of fulfillment in settlement; and instances where a third party would accept the transfer of such a liability from the obligor for a specified amount are likely to be rare. Therefore liabilities arising from non-exchange transactions are likely to be measured at the cost of fulfillment. The IPSASB concluded that it should emphasize this point to ensure that in a public sector context, the only practical and relevant measurement basis will often be the cost of fulfillment.

BC36. The analysis of the various measurement bases and the circumstances in which they may be relevant are consistent with the relief value model that was discussed in CF–CP3.
Other Issues

BC37. CF–CP3 sought the views of respondents on the following two issues related to measurement:

(a) The treatment of an entity’s own credit risk and changes in value attributable to changes in an entity’s own credit risk; and

(b) Whether the measurement of an asset should reflect only the service potential relating to its existing use, or whether the measurement of an asset should include the incremental value relating to its possible alternative use.

BC38. The majority of respondents who addressed these issues considered that they were more appropriately dealt with at the standards level than within the Framework. The IPSASB concurred with this view, and these issues are accordingly not dealt with in this Chapter. 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.
Alternative View of Mr. Ken Warren

AV1. The role of the Conceptual Framework is to establish the concepts that the International Public Sector Accounting Standards Board (IPSASB) will apply in developing International Public Sector Accounting Standards (this objective is set out in paragraph 1.1 of Phase 1 of the Framework). To successfully perform this role, the Conceptual Framework needs to build a framework that coherently integrates the objectives and qualitative characteristics (QCs) of financial reporting, the essential characteristics of the elements, the methodologies used to measure the elements and the manner in which the elements and other information are presented in financial reports.

AV2. As a standard setter the IPSASB decides whether an item of information should be recognized in the financial statements, when such an item should be recognized, and at what amount it should be recognized. For the IPSASB to make consistent decisions in developing standards, it is necessary to have (a) definitions of the elements of financial statements, (b) a basis for determining when elements of financial statements should be recognized in the financial statements, and (c) a basis for determining which measurement approach (for example, initial amounts, remeasured amounts, entry or exit notions) is appropriate for reporting the elements.

AV3. In developing the measurement section of its Conceptual Framework the IPSASB has decided not to identify a measurement objective on the basis that this might unduly restrict the choice of measurement bases, and could result in a measurement objective that competes with, rather than complements, the overall objectives of financial reporting and the QCs. In this member's opinion a Conceptual Framework that does not connect the objective of financial reporting with the objective of measurement is not complete and will limit the ability of the IPSASB to make consistent decisions across financial reporting standards and over time. Moreover, in the absence of a measurement objective, there is a risk that different and/or inappropriate measurement bases could be used to measure similar classes of assets and liabilities.

AV4. This member considers that a measurement objective is necessary to connect the overall objectives of financial reporting and the QCs rather than competing with them. This member seeks to demonstrate how a measurement objective could provide useful criteria for the IPSASB to consider when developing standards that impact on measurement, and how the IPSASB’s concerns regarding a measurement objective could be addressed.

A Measurement Objective

AV5. In order to develop a measurement objective we need to look first at the objectives of financial reporting. These objectives, as identified in the developing IPSASB framework, are to meet the information needs of users for accountability and decision-making purposes. Chapter 6: Measurement of Assets and Liabilities in Financial Statements asserts that a measurement basis will contribute to meeting these information needs if it provides information on:

(a) Financial capacity;
(b) Operational capacity; and
(c) The cost of services provided in the period.
AV6. It follows that an appropriate measurement objective would be to select those measurement attributes that most fairly reflect the financial capacity, operational capacity and cost of services of the reporting entity in a manner that is useful in holding the entity to account, and for decision-making purposes.

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

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

AV9. Some may argue it is not possible to make a distinction between operating and financial capacity. However, flows related to operating, investing and financing activities have been separately classified for some time (cf IPSAS 2, Cash Flow Statements), therefore the related stocks can be separately identified. Government Finance Statistics (GFS) makes a similar distinction when it determines net financial worth separately from net worth.

Measuring Financial Capacity

AV10. Measurement of financial capacity requires an assessment of the resources an entity has available to meet claims or which can be transformed into operating capacity. The financial claims of others on the entity would have the impact of reducing the entity's financial capacity.

AV11. Assets that provide financial capacity and financial liabilities have been acquired, issued, incurred or held with the expectation of generating returns or costs from interest, dividends and changes in market value. Given the purpose of holding such financial-capacity assets and liabilities, users seeking to hold the entity to account for its management of financial capacity and for making decisions relating to the entity's financial capacity are likely to find current measures and exit-based measures of those resources to be most useful. Such an approach will ensure that financial capacity resources that are transformed into operational capacity reflect current measures and so the inputs to services most fairly reflect their current cost. It also provides the most relevant information on the capacity of the entity to meet the claims of creditors and lenders.

AV12. In determining the most appropriate measurement base within a standard, the IPSASB would also need to consider the costs and risks of applying such measurement attributes against these benefits. In practice other measures may be used as good surrogates for the preferred measure where the preferred measure is not capable of being reliably determined. This does not negate the value of having a measurement objective.

AV13. Two common objections to the use of current exit based measures are complexity and volatility.

AV14. For example, application of current exit based measures to financial instruments would suggest that an effective interest rate approach to measurement is appropriate for interest bearing securities. Some have argued that requiring the use of effective interest rates is too complex and unnecessarily expensive for preparers, compared to a simpler amortized
approach. However, such complexity does not appear to impede the capital markets from carrying out such analyses, nor does it deter those markets from establishing prices for financial instruments generally.

AV15. A second risk often noted about using current, and exit based attributes to measure financial-capacity assets and liabilities, is the concern that they may conceal the financial results of operations by introducing unwarranted volatility in reporting. The benefits or disadvantages to an entity’s financial capacity that arise from changes in current exit values are however an important aspect of the entity’s financial performance, and can be easily distinguished from operating performance or the cost of services in the statement of financial performance.

**Measuring Operational Capacity and Cost of Services**

AV16. Public sector entities operations cover a vast span of activities. Common to all these activities is the fact that an entity transforms inputs into outputs. Inputs include not only assets such as labor, plant and equipment, and infrastructure assets but also the financial capacity of the entity.

AV17. In assessing the entity’s operational capacity and cost of services, users are interested in such matters as the nature and extent of the physical and other resources available to support the provision of services in future periods, the capacity of the entity to adapt to changing circumstances, the actual cost of services provided in the period compared to expectations, whether current levels of taxes and other income are sufficient to maintain the volume and quality of services currently provided, and whether resources have been used economically and efficiently.

AV18. Application of the proposed measurement objective to operational capacity and cost of services would involve selecting the measurement attribute that most fairly reflects the cost of services and operational capacity of the reporting entity in a manner that is useful in holding the entity to account, and for decision-making purposes. The measurement basis selected should be the most informative against the users interests described above.

AV19. The approach that would be most consistent with the measurement objective being proposed would be to measure operational capacity assets and obligations used as inputs to an entity’s services at current entry prices or, when such prices are not practical of faithful representation, on the basis of the most relevant substitute. The term “practicable of faithful representation” is intended to convey that the application of a measurement basis to an asset or liability should result in a number that can be demonstrated to reasonably represent the essential properties that are relevant to users in the context of the reporting entity’s financial report within a range of materiality. It does not simply mean that an asset or liability is faithfully represented because the measure faithfully represents the attributes of the measurement basis.

AV20. Using current entry prices for such assets and liabilities is consistent with the measurement objective and therefore the purpose of financial reporting. The use of current measures provides relevant and comparative information on the cost of services. The use of entry prices avoids the risk of anticipating value that is yet to be achieved by a reporting entity’s operations in transforming inputs into outputs that would be entailed in a fair value approach.
AV21. As in determining measurement bases for financial capacity assets and liabilities within a standard, the IPSASB would also need to consider the costs and risks of applying these measurement attributes against the benefits described above. In practice other measures may be used as good surrogates for the preferred measure. For example, actual costs of inputs recently acquired in a low inflation environment could be the most appropriate cost-effective measurement methodology for most inputs under this approach. This does not negate the value of having a measurement objective.

Conclusion

AV22. This member proposes that different measurement bases are needed to provide relevant and reliable information about financial capacity, operational capacity and cost of services. Financial capacity is best reflected by current exit prices, whereas operating capacity and cost of services is best reflected by current entry prices. Further, these measurement bases can be specified at a principle level in the Conceptual Framework, with detailed application requirements being found in standards.

AV23. In determining the most appropriate measurement base within a standard, the IPSASB would need to consider the costs and risks of applying such measurement attributes against these benefits. When the preferred measure is not capable of being reliably determined or is not practicable of faithful representation the most relevant substitute that is practicable faithful of representation could be used. This does not negate the value of having a measurement objective.
Appendix 1A

The IASB Conceptual Framework (September 2010)

Measurement of the Elements of Financial Statements

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

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

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

It notes that the measurement basis most commonly adopted is historical cost, which is usually combined with other measurement bases.
Appendix 1B

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

Measurement of the Elements of Financial Statements

The Government Finance Statistics Manual 2001 (GFSM 2001) includes guidance on the valuation of assets and liabilities as follows:

- The value of an asset is its current market value which is the amount that would have to be paid to acquire the asset on the valuation date, taking into account its age, condition, and other relevant factors. This amount depends on the economic benefits that the owner of the asset can derive by holding or using it.

- For nonfinancial assets the current market value includes all transport and installation charges and all costs of ownership transfer.

- The ideal source of price observations to obtain a current market value is a market in which the identical assets are traded in considerable volume and their market prices are listed at regular intervals. If there are no observable prices then a price or value has to be estimated. Possible methods of estimating current market prices include:
  - Securities that are not traded—this value can be estimated by reference to similar securities that are traded on a stock exchange by analogy, making an allowance for the inferior marketability of the non-traded securities.
  - Written-down replacement cost—this value is the original acquisition value of the asset adjusted by an allowance for price changes and then written down for the accumulated consumption of fixed capital.
  - Appraisals of tangible assets for insurance or other purposes—this value is generally based on observed prices for items that are close substitutes.

- The valuation of liabilities is the same as the valuation of the corresponding financial assets.