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Submitted to: www.ifac.org

Dear Stephenie

***Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities:
Measurement of Assets and Liabilities in Financial Statements***

The New Zealand Accounting Standards Board (NZASB) is pleased to submit its comments on the Conceptual Framework Exposure Draft 3, *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Measurement of Assets and Liabilities in Financial Statements* (CF ED 3). The ED has been issued for comment in New Zealand and as a result you may also have received comments directly from New Zealand constituents.

General comments

The NZASB compliments the International Public Sector Accounting Standards Board (IPSASB) on its commitment to, and progress in, developing a conceptual framework for general purpose financial reporting by public sector entities. In particular, the NZASB compliments the IPSASB for tackling the difficult topic of measurement for which other frameworks do not provide much guidance.

We note that the International Accounting Standards Board (IASB) has recently recommenced its work on a conceptual framework for for-profit entities. We encourage the IPSASB and the IASB to work closely together in developing their conceptual frameworks as the two Boards are likely to be considering similar issues. We consider that the development of the conceptual frameworks is too important for the two Boards to be working independently of each other. Ideally, the IPSASB and IASB Frameworks should only contain different concepts that result from sectoral differences.

The NZASB considers that identifying and describing different measurement bases and classifying them as either an entry-price or an exit-price, and either entity or non-entity specific, will be helpful for selecting a measurement base in a standard (and applying the measurement base in practice). This is because these descriptions and classifications clarify what it is that a particular measurement base is intended to measure. Also, the discussion of various measurement bases in relation to the objectives and qualitative characteristics of financial reporting should help when selecting a particular measurement base in a standards-level project.

Regarding further classifications of measurement bases, we do not consider it necessary to classify measurement bases as either 'observable' or 'non-observable' in a market. Whether a measurement base is observable or not is to do with the type of evidence available to support that measurement rather than what the measurement base is intended to represent. Also, we do not consider it necessary to distinguish between the two 'types' of market values set out in the table in paragraph 3.2 of the ED. Whether an entity is estimating a market value in an inactive or active market, the measurement objective is still the same, that is, to determine a market-participant (non-entity-specific) view of the current exit price.

Further, we consider that it would be useful if the IPSASB explained the need for mixed measurement and the conditions under which specific measurement bases might be appropriate. We discuss this further below in our discussion of the need for a measurement objective. We consider that the IPSASB should explain the differences between the available measurement bases and why these differences result in mixed measurement being more appropriate than a single measurement basis for all assets and liabilities or other measurement bases.

Primary concerns

The NZASB's primary concerns with the proposals in the ED relate to:

1. the absence of an overall measurement objective;
2. the use of 'fair value' as a measurement method rather than a measurement base; and
3. specific aspects of some proposed measurement bases.

Absence of a measurement objective

Need for a measurement objective

We note the IPSASB's decision not to include a measurement objective in guiding the selection of a measurement basis. We consider an overall measurement objective essential to provide a clear link between measurement bases and the objectives and qualitative characteristics of financial reporting.

Setting a measurement objective would not unduly restrict the IPSASB; rather, it should guide the IPSASB in consistent selection of appropriate measurement bases in standards-level projects. This is particularly important as many doubt that there is a single measurement basis that is likely to ensure that reported information fulfils all the qualitative characteristics. A measurement objective will also guide preparers in establishing appropriate accounting policies for transactions not covered by International Public Sector Accounting Standards (IPSAS).

We acknowledge that the development of a measurement objective would not necessarily lead to unequivocal decisions about the appropriateness of measurement bases. However, without a measurement objective, there is a risk that the selection of measurement bases may be arbitrary and, hence, will undermine the quality and usefulness of information reported.

In this regard, we strongly support the alternative view of Mr Ken Warren. We agree with the proposed measurement objective and rationale set out in the Mr Warren's alternative view.

Development of a measurement basis

A measurement objective must be designed to meet the objectives of financial reporting. In Section 1 of the ED, the IPSASB asserts that a measurement basis will contribute to meeting the information needs of users if it provides information that enables assessments of:

1. Financial capacity;
2. Operational capacity; and
3. The cost of services provided in the period.

Measurement of financial capacity provides information to assess the extent of the resources an entity has available to meet financial claims or which can be transformed into operating capacity. In our view, the fair value measurement basis is likely to best operationalise the measurement objective of fairly reflecting financial capacity.

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. In our view, in most cases the deprival value basis is likely to best operationalise the measurement objective of fairly reflecting operating capacity.

Comments on specific measurement bases and models

Fair value: Measurement base or measurement model

We consider 'fair value' to be a measurement base rather than a measurement model. The 'fair value model' discussed in paragraphs 4.5-4.8 of the ED represents a measurement model as distinct from a measurement base.

The definition of market value in paragraph 3.3 of the ED is the 'old' definition of 'fair value', that is, the definition currently used in IPSAS and in International Financial Reporting Standards (IFRS) before the adoption of IFRS 13 *Fair Value Measurement*. This definition has always raised doubts as to whether it is an entry or exit price (for example, it refers to exchange of an asset instead of the sale of an asset) whereas the new definition in IFRS 13 is clearly an exit price. Given that the ED effectively treats market value as an exit price, we consider that the IPSASB should adopt the IFRS 13 definition of fair value.

Defining 'market value' as what currently is considered to be 'fair value', and defining 'fair value' as a method for determining 'market value', is confusing and circular. We recommend using

'fair value' rather than 'market value' as the descriptor of the measurement basis (while acknowledging that, as with all measurement bases in section 3 of the ED, it is rarely possible to measure assets and liabilities with absolute accuracy). We consider that it is important to avoid any confusion in this area, particularly for public sector entities that must consolidate government business enterprises applying IFRS.

Market value of liabilities

We consider the discussion of market value in the context of liabilities to be confusing and inconsistent with other parts of the ED.

Paragraph 5.6 of the ED describes the market value of a liability as a transfer price. Describing the market value of a liability as a transfer price is consistent with the new definition of fair value in IFRS 13, which refers to the price at which a liability could be transferred. However, this is inconsistent with the definition of market value in paragraph 3.3 of the ED, which refers to 'settling' a liability, not transferring it.

The ED goes on to discuss two different types of settlement of a liability – immediate settlement (in the discussion of cost of release in paragraphs 5.7-5.11 of the ED), and settlement over time in accordance with the obligations (in the discussion of cost of fulfilment in paragraphs 5.18-5.25 of the ED). These are different measurement bases to market value. From the discussion of these measurement bases it seems clear that the IPSASB considers the 'market value' of a liability to be its current transfer price (that is, a market participant view of its current exit price).

We recommend that the definition in paragraph 3.3 of the ED be amended to refer to transfer of a liability rather than settlement of a liability.

Deprival value

The ED states that deprival value reflects the loss that the entity would sustain if it were deprived of the asset, or the amount that the entity would rationally pay to acquire the asset, if it did not already control it. This is sufficient at a conceptual level. However, the ED then goes on to state that the deprival value model is a decision-making model for selecting or confirming a measurement basis. We consider the discussion of how to go about selecting an appropriate calculation method for determining deprival value to be standards-level discussion. Similarly, we consider that much of the discussion of the fair value model (that is, how to determine market value) to be standards-level discussion.

While in the 'normal case' the diagram at paragraph 4.9 of the ED is appropriate, we note that specific cases can be defined where the net selling price (net realisable value) is greater than replacement cost and value in use. If net selling price exceeds optimised depreciated replacement cost it would, in normal circumstances, indicate that there is a redevelopment or redeployment opportunity associated with the asset. In that case there is an argument in the for-profit sector that its deprival value should be measured as net selling price (whereas application of the rule stated in Diagram 1, paragraph 4.1 of the ED would lead to measurement at replacement cost)¹. Some not-for-profit public sector entities which have assets with a net selling price (net realisable value) which is greater than replacement cost and value in use, may

¹ This argument is developed fully in Van Zijl, T. and Whittington, G. (2006) "Deprival value and fair value: a reinterpretation and a reconciliations." *Accounting and Business Research*, 36(2): 121-130.

not be able to avail themselves of redeployment opportunities. This may occur when assets are held for cultural or environmental reasons, and the political environment actively discourages the entity from redeploying or redeveloping capacity. We encourage the IPSASB to further explore when these issues might arise, where conceptually these examples differ from the for-profit application, and to develop a framework which responds to such situations.

We note that the fair value of operational assets held by public sector entities would normally be estimated by replacement cost. Therefore, there might be little practical difference between use of fair value and deprival value. However, application of deprival value, reinterpreted as in van Zijl and Whittington (2006), might usefully highlight the existence of redevelopment or redeployment opportunities associated with an operational asset and, therefore, cause users of public sector financial statements to consider whether or not there is a public sector reason for retaining the asset.

We recommend changing the definition of recoverable amount (in paragraph 4.11 of the ED) to that adopted in IPSAS 21 *Impairment of Non-Cash-Generating Assets* and IPSAS 26 *Impairment of Cash-Generating Assets*, that is the higher of fair value less costs to sell and value in use, rather than the higher of net selling price and value in use.

We also recommend renaming 'replacement cost' as 'optimised depreciated replacement cost'. This would explicitly recognise that the cost refers to replacement of the service potential rather than the actual asset. Paragraphs 3.20 and 3.21 of the ED explicitly recognise this need to value the optimised depreciated replacement cost.

Responses to specific matters for comment

Our responses to specific matters for comment, and other comments, are included in the appendix to this letter.

If you have any queries or require clarification of any matters in this submission, please contact Clive Brodie (clive.brodie@xrb.govt.nz) or me.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Michele Embling', written over a large, light-colored circular scribble.

Michele Embling

Chairman – New Zealand Accounting Standards Board

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APPENDIX

Response to specific matters for comment

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 measurement objective please indicate what this measurement objective should be and give your reasons.

The NZASB agrees 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. We consider that it is important to assess whether information provided by the measurement basis that has been chosen meets the overall objectives of financial reporting and the qualitative characteristics in the context of concepts of capital maintenance.

However, the NZASB considers it essential that there is a measurement objective to link the overall objectives of financial reporting and the qualitative characteristics to decisions on which measurement basis to use in particular circumstances. In this regard, we strongly support the measurement objective, and the underlying reasons, set out in Mr Warren's alternative view.

Specific Matter for Comment 2:

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

We recommend the following current value measurement bases:

1. Fair value: As discussed in our covering letter, we consider fair value to be a measurement base rather than a measurement model.
2. Optimised depreciated replacement cost: As discussed in our covering letter, we recommend renaming 'replacement cost' as 'optimised depreciated replacement cost'.
3. Fair value less costs to sell: As discussed in our covering letter, we suggest that net selling price be replaced with fair value less costs to sell.
4. Value in use: We agree with value in use as a measurement basis.

Specific Matter for Comment 3:

Do you agree with the approaches proposed in Section 4 for application of:

- (a) The fair value measurement model to estimate the price at which a transaction to sell an asset would take place in an active, open and orderly market at the measurement date under current market conditions. If not, please give your reasons; and
- (b) The deprival value model to select or confirm the use of a current measurement basis for operational assets. If not please give your reasons.

(a) The fair value model

As discussed in our covering letter, we do not agree with the approach in the ED of defining fair value as a measurement model rather than as a measurement basis. Given that the ED effectively treats market value as an exit price, we consider that the IPSASB should adopt the new IFRS 13 definition of fair value.

(b) Deprival value model

As stated in our covering letter, we do not agree with the inclusion in the conceptual framework of a discussion on the application of the deprival value model. Discussion of how to go about selecting an appropriate calculation method for determining deprival value we consider to be a standards-level discussion.

Specific Matter for Comment 4:

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?

As discussed in our covering letter, we recommend that the definition in paragraph 3.3 be amended to refer to the transfer of a liability rather than settlement of a liability. Otherwise, we agree with the proposed measurement bases for liabilities in Section 5 of the ED.

Other miscellaneous comments

Paragraph 1.5 of the ED gives historical cost as an example of an entry value. We recommend that fair value be provided as an example of an exit value.

Paragraph 3.13 of the ED suggests that, if market values are low, historical cost will likely provide the most relevant information about operating capacity. We recommend that this statement be clarified. If market value is low an asset may be impaired, in which case the impaired historical cost would provide relevant information. Also, the paragraph seems to imply that, in the public sector, low market values should be ignored. However, if the market value is low but the asset is not impaired, this is likely due to the value in use of the asset being higher, rather than the low market value being irrelevant. Further, the paragraph seems to assume that, regardless of the low market value, there is always still a need for the services provided for which the assets are used. This does not address the case where the market value plummets due to a decline in the desire or need for a service.

Paragraph 3.15 of the ED states that market value will meet the qualitative characteristics. If the selection of a measurement basis is based on the extent to which a particular measurement basis meets the objectives of financial reporting this paragraph then implies that market value is best in all circumstances and so contradicts other paragraphs in the ED, such as paragraph 3.13, which states that, where market values are low, historical cost provides more relevant information.