

Meeting: IPSASB Consultative Advisory Group
Meeting Location: Luxembourg, Luxembourg
Meeting Date: June 26, 2017

Agenda Item 5

For:
☐ Approval
☒ Discussion
☐ Information

Public Sector Measurement

Project summary	<p>This project will address inconsistencies between measurement in IPSAS and in the Conceptual Framework.</p> <p><i>Project objectives:</i> Improvements to IPSAS measurement, including disclosures; implementation guidance on measurement; clarification of treatment of transaction costs and borrowing costs.</p>	
	Topics	Agenda Item
Discussion of Public Sector Measurement Issues	Introduction to the Project	5.1
	1. Guidance needed to improve public sector measurement	
	2. Options to address the IPSAS fair value problem	
Supporting items	<p>Public Sector Measurement Project: Progress and Roadmap:</p> <ul style="list-style-type: none"> • Decisions • Roadmap • IPSASB Discussions 	5.2

Agenda Item

5.1

Public Sector Measurement Project

Introduction

1. This paper describes the Public Sector Measurement Project and asks CAG members for their views on the following questions:
 - (a) What are the difficult topics in public sector measurement, for which implementation guidance would be most helpful?
 - (b) What options should the IPSASB consider to solve the “fair value problem” in IPSAS?

Project on Public Sector Measurement

Why this project? How will it contribute to the public interest?

2. This project’s rationale is that IPSAS should reflect the Conceptual Framework’s approach to measurement¹. Other improvements to IPSAS measurement will be considered, including provision of more implementation guidance. The project brief does not envisage fundamental changes to IPSAS measurement. It links to other IPSASB projects, for example the Heritage, Infrastructure, and Social Benefits projects.
3. This project is expected to contribute to the public interest by improving the discussion of measurement in IPSAS. As a result, IPSASs should:
 - (a) Do a better job on measurement requirements for public sector-specific assets and liabilities, so that information in financial statements will be more useful;
 - (b) Be more consistent in their approach to measurement to support comparability; and
 - (c) Be clearer and more understandable, with implementation guidance for the more difficult public sector specific issues.
4. The Conceptual Framework guides this project’s consideration of measurement. Appendix A has the Conceptual Framework’s measurement objective, measurement bases for assets and liabilities, and a Basis of Conclusions excerpt on why fair value is not a measurement base.
5. The project will also consider IPSASB policies on convergence with International Financial Reporting Guidelines (IFRS) and reduction of differences between IPSASs and Government Finance Statistics (GFS) reporting guidelines².

Fair Value Problem—Is fair value still a viable measurement basis in IPSAS?

6. Fair value is used throughout IPSAS. However, the Conceptual Framework does not include fair value in its list of measurement bases. Instead it uses the term “market value”.
7. The Conceptual Framework’s definition of “market value” and the IPSAS definition of “fair value” are the same:

¹ Paragraph 2.1 of the Public Sector Measurement project brief.

² *The Process for Reviewing and Modifying IASB Documents* (2008) and the *Process for Considering GFS Reporting Guidelines during Development of IPSASs* (2014).

...the amount for which an asset could be exchanged, or a liability settled between knowledgeable, willing parties in an arm's length transaction.³

8. This definition is different from the one in the International Accounting Standards Board (IASB)'s IFRS 13, *Fair Value Measurement*, which defines fair value to be an exit value:

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.

9. This IFRS 13 meaning for fair value is gaining general acceptance in the accounting world. IFRS 13 has a clear explanation of fair value, with guidelines on the derivation of fair value.

Fair Value and Public Sector Specific Differences

10. When developing the Conceptual Framework the IPSASB concluded that an exit value would not be appropriate for many public sector assets and liabilities⁴. For example, exit value measurement (a sale price) can understate public sector assets' service potential.
11. It is difficult to see how IPSAS can continue to use the term "fair value", given that this:
- (a) Would not be consistent with the Conceptual Framework; and
 - (b) Is likely to be confusing, given the different meaning in IFRS 13.
12. IPSAS measurement presently has the same problems with fair value as those that the IASB had before it developed IFRS 13. For example, the meaning of fair value in IPSAS is often unclear in terms of whether it is an entry or exit value. This problem impacts on initial measurement of assets, because fair value is used for initial measurement when assets are transferred in a non-exchange transaction and when an entity first adopts accrual IPSAS and has no information on the historical cost of assets.

The Project's Task Force

13. The project's Task Force, consists of David Watkins (Chair), Aracelly Mendez, Francesco Copalbo, Takeo Fukiya, and an International Valuation Standards Council (IVSC) representative (to be determined). Other IPSASB members and representatives from the Government Finance Statistics (GFS) community will be called on to contribute as appropriate.

Project's Multi-Stage Approach and its Outputs

14. This project is taking a multi-stage approach as follows:
- Stage 1: Do a survey of measurement requirements in IPSAS, comparing them to the Conceptual Framework and IFRS 13.
 - Stage 2: Use the resulting measurement inventory to decide on the project's next steps.
15. The project's intermediate outputs are to produce a Consultation Paper identifying options and then an Exposure Draft of proposed changes to IPSASs. Its final outputs are expected to be:

³ Paragraph 7.24 of the *Conceptual Framework* and paragraph 11 of IPSAS 9, *Revenue from Exchange Transactions*.

⁴ See particularly paragraph BC 7.25 of Chapter 7's *Basis for Conclusions*, which is provided in Appendix A of this paper.

- (a) *IPSAS amendments*: Revised requirements for measurement at initial recognition, subsequent measurement and measurement-related disclosure;
- (b) *Implementation guidance* on measurement bases; and
- (c) *Transaction costs*: Revisions to clarify the treatment of transaction costs and revisions to the treatment of borrowing costs when measuring assets and liabilities.

Topic 1: Guidance on Measurement

Questions

What are the difficult topics in public sector measurement, where implementation guidance would be most helpful?

Information

Public Sector Specific Differences and Measurement of Assets and Liabilities

1. The Preface to the Conceptual Framework describes special characteristics of the public sector with implications for financial reporting⁵. This discussion highlights the following differences:
 - (a) Non-exchange transactions are common in the public sector.
 - (b) Public sector entities' reasons for holding assets and incurring liabilities are different:
 - (i) Assets provide service potential rather than generate cash flows. They are not held for sale—for example, heritage assets and national parks.
 - (ii) Obligations are incurred for policy reasons, including provision of social benefits.
 - (c) The nature of public sector assets and liabilities is different, for example:
 - (i) *Specialized assets*: A large proportion of public sector assets are specialized—for example, roads and other infrastructure and military assets.
 - (ii) *Limited market*: Assets may have a limited market and need considerable adaptation before being used by other operators.
2. IPSAS already tries to address such differences. For example:
 - (a) Assets acquired in a non-exchange transaction are initially measured at fair value, because cost could be a nominal value that understates their service potential⁶.
 - (b) There are accounting options and implementation guidance for many public sector specific measurement issues.
3. Nonetheless, constituents have said that more needs to be done, which is why projects to address public sector specific issues are a priority for the IPSASB.

IPSASB views on what guidance is needed—Appendix B

4. Appendix B has a summary of responses from IPSASB members and technical advisors, who have contributed their initial views on guidance needs in May of this year. These are provided for information, so that CAG members can consider whether they (a) agree with these topics, and (b) have other topics to add to this initial list of guidance needs.

⁵ See, for example, paragraphs 5-7 of *The Preface to the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*.

⁶ Paragraph 42 of IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*.

CAG Views Requested

CAG members are asked to provide their views on the difficult topics in public sector measurement, where implementation guidance would be most helpful.

Topic 2: The Fair Value Problem

Question

What options should the IPSASB consider to address the “fair value problem” in IPSAS?

Information

1. Paragraphs 6 to 12 above, in the project description, describe the fair value problem. The IPSASB is at a very early stage of this project. It has not yet:
 - (a) Identified options for consideration; or
 - (b) Begun to discuss options in order to reach a preliminary view on a solution.
2. Staff proposes that two options for discussion are:
 - (a) Replace the term fair value with “market value” in IPSAS, to reflect the Conceptual Framework’s approach to measurement; or
 - (b) Continue to use the term “fair value” in IPSAS, defined as in IFRS 13, *Fair Value Measurement*.
3. Each option raises further questions on how to proceed. For example,
 - (a) If “market value” replaces fair value in IPSAS, should the IPSASB develop guidance on market value (similar to the IFRS 13 guidance on fair value)?
 - (b) If IPSAS continues to use the term “fair value” should IPSAS measurement also:
 - (i) Use market value: and, if so,
 - (ii) When should assets and liabilities be measured using fair value and when should they be measured using market value?
4. There may be other ways to address the fair value problem. This is something that the Task Force and the IPSASB will be discussing as the project proceeds, using the information gained from the survey of IPSAS measurement.

CAG Views Requested

CAG members are asked to provide their views on options that the IPSASB should consider to address the fair value problem in IPSAS.

APPENDIX A: CONCEPTUAL FRAMEWORK EXCERPTS

Measurement Objective

The objective of measurement is to select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes. [CF, paragraph 7.2]

The selection of a measurement basis also includes an evaluation of the extent to which the information provided achieves the qualitative characteristics while taking into account the constraints on information in financial reports⁷. [CF, paragraph 7.4]

Measurement Bases in the Conceptual Framework

Measurement Bases for Assets

The Conceptual Framework identifies the following measurement bases for assets:

- Historical cost: The consideration given to acquire or develop an asset, which is the cash or cash equivalents or the value of the other consideration given, at the time of its acquisition or development. [CF, paragraph 7.13]
- Market value: The amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction. [CF, paragraph 7.24]
- Replacement cost: 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. [CF, paragraph 7.37]
- Net selling price: The amount that the entity can obtain from sale of the asset, after deducting the costs of sale. [CF, paragraph 7.49]
- Value in use: The present value to the entity of the asset's remaining service potential or ability to generate economic benefits if it continues to be used, and of the net amount that the entity will receive from its disposal at the end of its useful life. [CF, paragraph 7.58]

Measurement Bases for Liabilities

- Historical cost: The consideration received to assume an obligation, which is the cash or cash equivalents, or the value of the other consideration received at the time the liability is incurred. [CF, paragraph 7.70]
- Cost of fulfillment: The costs that the entity will incur in fulfilling the obligations represented by the liability, assuming that it does so in the least costly manner. [CF, paragraph 7.74]
- Market value: The amount for which a liability could be settled between knowledgeable, willing parties in an arm's length transaction. [CF, paragraph 7.80]

⁷ The qualitative characteristics of information included in GPFRs of public sector entities are relevance, faithful representation, understandability, timeliness, comparability, and verifiability. The pervasive constraints are materiality, cost benefit, and achieving an appropriate balance between the qualitative characteristics. [CF paragraphs 3.2 and 3.3]

Cost of release: The term used in the context of liabilities to refer to the same concept as “net selling price” in the context of assets. Cost of release refers to the amount of an immediate exit from the obligation. Cost of release is the amount that either the creditor will accept in settlement of its claim, or a third party would charge to accept the transfer of the liability from the obligor. Where there is more than one way of securing release from the liability, the cost of release is that of the lowest amount—this is consistent with the approach for assets, where net selling price would not reflect the amount that would be received on sale to a scrap dealer, if a higher price could be obtained from sale to a purchaser who would use the asset. [CF, paragraph 7.82]

Assumption price: The term used in the context of liabilities to refer to the same concept as replacement cost for assets. Just as replacement cost represents the amount that an entity would rationally pay to acquire an asset, so assumption price is the amount which the entity would rationally be willing to accept in exchange for assuming an existing liability. Exchange transactions carried out on arms-length terms will provide evidence of assumption price—this is not the case for non-exchange transactions. [CF, paragraph 7.87]

Basis for Conclusions Excerpt: Market Value and Fair Value

- BC7.20 The Exposure Draft did not propose fair value as a measurement basis. Rather it proposed market value, which was defined in the same way as fair value in the IPSASB's literature at the time the Conceptual Framework was developed. A number of respondents challenged the omission of fair value as a measurement basis. They pointed out that fair value is a measurement basis that is defined and used in specifying measurement requirements by many global and national standard setters and that a definition of fair value had been used extensively in IPSASB's literature. Many supporters of fair value considered that the definition should be an exit value as defined in International Financial Reporting Standards (IFRS).⁸
- BC7.21 The IPSASB's rationale for the approach proposed in the Exposure Draft was that fair value is similar to market value and the inclusion of both measurement bases could be confusing to users of financial statements. The IPSASB also noted that fair value in IFRS is explicitly an exit value—unlike the definition of fair value in the IPSASB's literature at the time the Conceptual Framework was developed. Therefore, the relevance of fair value in the public sector is likely to be primarily limited to providing information on financial capacity, rather than on providing information on operating capacity and the cost of services. In addition, in this chapter replacement cost is a measurement basis in its own right, rather than a valuation technique to determine fair value.
- BC7.22 In the public sector many assets are specialized and differences in entry and exit prices are therefore significant. Where an asset will provide future services or economic benefits with a greater value than the asset's exit price, a measure reflecting exit values is not the most relevant basis. Where the most resource efficient course is to sell the asset—because the value of the services that it will provide or the expected cash flows from use is not as great as the value receivable from sale, the most relevant measurement basis is likely to be net selling

⁸ IFRS 13, *Fair Value Measurement*, provides the definition of fair value.

price, which reflects the costs of sale and, although likely to be based on market evidence, does not assume the existence of an open, active and orderly market.

- BC7.23 In considering the merits of fair value as a measurement basis, the IPSASB accepted that fair value provides a relevant basis for assessing a financial return. Where assets are stated at fair value, financial performance can be assessed in the context of the return implicit in market values. However, public sector activities are not generally carried out with a view to obtaining a financial return, so the relevance of assessing any such return is limited.
- BC7.24 In finalizing the measurement chapter the IPSASB considered three main options in dealing with this issue:
- Adopt an exit value-based definition of fair value;
 - Retain the definition of fair value in IPSAS prior to the development of the Conceptual Framework; or
 - Include market value, rather than fair value, as a measurement basis as proposed in the Exposure Draft.
- BC7.25 Adopting an exit value-based definition of fair value would have meant using a definition that is not well aligned with the objectives of most public sector entities—the delivery of services rather than the generation of cash flows. It is questionable whether exit value-based measures would provide relevant information for many assets held for their operational capacity and for liabilities where it is not feasible to transfer the liability.
- BC7.26 Including the IPSASB's current definition of fair value or a slightly modified version of that definition in the Conceptual Framework would have meant that two global standard setters would have different conceptual definitions of the same term.
- BC7.27 The IPSASB acknowledged that not including fair value as a measurement basis would have implications for the IPSASB's extant literature at the time the Conceptual Framework was finalized, because a number of IPSAS's contained fair value in measurement requirements or options.
- BC7.28 On balance, the IPSASB concluded that, rather than include an exit value-based definition of fair value, or a public sector specific definition of fair value, the Conceptual Framework should include market value as a measurement basis rather than fair value. The IPSASB sees fair value as a model to represent a specific measurement outcome. The IPSASB may carry out further work at standards level to explain how the measurement bases in this chapter align with fair value, as implemented in IFRS.

APPENDIX B: IMPLEMENTATION GUIDANCE—IPSASB RESPONSES TO SURVEY

IPSASB members and technical advisors identified the following guidance topics:

1. *Terminology*: For terms such as cost, expense, value and price; provide consistent and clear definitions, guidance and explanations on when to use each term.
2. *Choice of measurement base*: A decision tree or other guidance on how to choose:
 - (a) The most appropriate measurement base in different circumstances. For example, whether to use replacement cost (to reflect service potential) or a commercial discounted cash flow (to reflect economic benefits) for assets that have mixed objectives.
 - (b) Between reliable measurement (e.g. historical cost) and other measurement bases that require judgment and/or introduce volatility (e.g. fair value or replacement cost).
 - (c) The measurement bases that should be used if information on fair value and cost is not available when applying IPSAS 33, *First-Time Adoption of Accrual Basis IPSASs*.
3. *Measurement bases*: Guidance as follows:
 - (a) *Fair value*: There is a general lack of understanding of how to determine fair value:
 - (i) Clarification of fair value in IPSASs, including guidance on IFRS 13, *Fair Value Measurement*, which is relevant to public sector specific financial instruments, e.g. unquoted equity instruments or concessionary loans at initial recognition. An IFRS 13 equivalent standard or guidance on fair value would be useful.
 - (ii) Guidance on fair value for non-financial assets.
 - (iii) How fair value/market value should be determined when no or an inactive market.
 - (iv) Allocation of 'fair value' amongst individual assets where 'fair value' has historically been assessed on a group basis.
 - (b) *Market value*: The boundary between market value and fair value should be clarified.
 - (c) *Replacement cost*:
 - (i) Guidance on the concepts of "replacement cost" and "optimized replacement cost" when measuring assets. When measuring infrastructure the engineering perspective for valuations could be useful.
 - (ii) Guidance for consistency across different IPSASs (e.g. IPSAS 17, *Property, Plant and Equipment* (IPSAS 17), and impairment IPSASs (IPSAS 21 and IPSAS 26).
 - (d) *Value in use*: Guidance for consistent application across different IPSASs. Also, guidance for measuring the value-in-use of cash and non-cash generating assets for impairment testing purposes, especially determining an appropriate discount rate.
 - (e) *Deemed cost*: Application guidance to determine deemed cost in accordance with IPSAS 33, *First-time Adoption of Accrual Basis IPSASs*.
4. *Specific public sector assets and liabilities*: Guidance on measurement of:
 - (a) *Military assets*.

- (b) *Heritage*: Note that there is no guidance in IPSAS 17, although measurement is difficult. Issues include whether measurement should reflect the nature of the asset in its current use or its heritage value.
 - (c) *Infrastructure*; for example guidance on:
 - (i) Impairment of network assets, where only a portion of the network is damaged.
 - (ii) Measurement when historical cost is not available.
 - (iii) Measurement focus in terms of components (e.g. whether such assets should be valued based on the different parts comprising the asset (pipes, cement, etc.), based on sections of the assets (e.g. per kilometre of road), etc.)
 - (iv) Note that there is no guidance on measurement of infrastructure assets in IPSAS 17, *Property, Plant and Equipment*.
 - (d) *Agriculture*: Fair value measurement for IPSAS 27, *Agriculture*, is causing significant implementation issues in at least one national jurisdiction.
 - (e) *Non-cash-generating assets* (held for their service potential rather than future cash flows): Guidance for more objective, non-entity specific values. Issues include determination of “highest and best use”.
 - (f) *Landfill sites*: Provisions for rehabilitation of landfill sites: Asset/ liability recognition and measurement.
 - (g) *Investments in unquoted shares*, when fair value is difficult to obtain.
5. *Unable to measure*: Guidance on how to assess measurability for recognition. Several IPSASs allow non-recognition of an asset if it cannot be reliably measured. What is meant by a “reliable estimate” of the asset’s value in existing IPSASs? How to apply the Conceptual Framework’s principle that measurement should achieve the qualitative characteristics?
6. *Remeasurement frequency*: Guidance on how frequently to remeasure; considers costs.
7. *Discount rates*:
- (a) Guidance on selection of discount rates to reflect the specific measurement objective/basis, e.g. how does a current rate of interest reflect the “cost of fulfillment” for liabilities?
 - (b) Determining discount rates (including risk adjustments for assets) consistently across all IPSASs, especially when cash flows extend beyond observable market yields information.
8. *Valuation models*: Appropriateness of inputs in valuation models and understanding whether inputs are observable or unobservable.
9. *Restrictions on assets*: Identification of entity-specific versus asset-specific restrictions.
10. *Subsequent measurement*: Relationship between measurement model, depreciation, and impairment.
11. *Related guidelines*: Other authoritative sources and guidance:
- (a) Provide links to International Valuation Standards Council (IVSC)’s guidance.

- (b) Clarify government finance statistics (GFS) reporting guidelines and how these differ from IPSAS in theory and in practice.
- (c) “How to” application guidance, including how to meeting GFS reporting requirements.

Agenda Item 5.1

PUBLIC SECTOR MEASUREMENT PROJECT: PROGRESS TO DATE AND ROADMAP**IPSASB Decisions—March 2017 meeting and earlier**

Meeting	Decisions
March 2017	Approved revisions to the project brief.
September 2015 to December 2016	No decisions as project awaited start. First discussion planned for March 2017.
June 2015	Approved the “Public Sector Measurement” project brief.

Agenda Item

5.2

PUBLIC SECTOR MEASUREMENT PROJECT ROADMAP

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